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In The

Supreme Court of the United States

October Term, 1993

1605 BOOK CENTER, INC.,

Petitioner,

v.

TAX APPEALS TRIBUNAL OF THE STATE OF NEW YORK and COMMISSIONER OF TAXATION AND FINANCE OF THE STATE OF NEW YORK,

Respondents.

Petition For A Writ Of Certiorari To The Court Of Appeals Of The State Of New York

PETITION FOR A WRIT OF CERTIORARI

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QUESTION PRESENTED

Does the First Amendment require that when a person makes a colorable claim, in a noncriminal case, that a tax, or other law, is being selectively enforced in a way that impinges on the exercise of free speech, then the state bears the burden of establishing that there is no invidious discrimination?

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TAX APPEALS TRIBUNAL OF THE STATE OF NEW YORK and COMMISSIONER OF TAXATION AND FINANCE OF THE STATE OF NEW YORK,

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PETITION FOR A WRIT OF CERTIORARI

Petitioner 1605 Book Center, Inc.,[1] prays for a writ of certiorari to review the judgment of the Court of Appeals of the State of New York.

OPINIONS BELOW

The opinion of the Court of Appeals of the State of New York is reported at 83 N.Y.2d 240, 609 N.Y.S.2d 144,

[1] The parent company of 1605 Book Center, Inc., is C&F Merchandising, Ltd., New York, New York.

631 N.E.2d 86 (1994), and is reprinted in the appendix at App. 1. The opinion of the Supreme Court of the State of New York, Appellate Division, Third Department, is reported at 188 A.D.2d 694, 590 N.Y.S.2d 591 (3d Dept. 1992), and is reprinted in the appendix at App. 9. The opinion of the Tax Appeals Tribunal of the State of New York is unreported and is reprinted in the appendix at App. 15. The opinion of the Division of Tax Appeals of the State of New York is unreported and is reprinted in the appendix at App. 48.

JURISDICTION

The judgment of the Court of Appeals of the State of New York, was entered on February 15, 1994. This petition for a writ of certiorari is filed within ninety days of entry of the judgment, in compliance with Rule 13 of this Court's rules. The Court's jurisdiction is invoked under 28 U.S.C. § 1257.

CONSTITUTIONAL PROVISION INVOLVED

United States Constitution, Amendment XIV, provides in pertinent part:

> No State shall make or enforce any law which shall abridge the privileges or immunities of the citizens of the United States; nor shall any State deprive any person of life, liberty, or property, without due process of law; nor deny to any person within its jurisdiction the equal protection of the laws.

STATEMENT OF THE CASE

Seldom has there been so shocking a case of selective enforcement of a tax in direct violation of a person's right to equal treatment under the law. The decisions below are patently at odds with the Fourteenth Amendment's principle entitling everyone to equal protection under the law and present a question of sufficient significance to warrant the full attention of this Court.

The facts relevant to the issue presented by this petition are for the most part undisputed and, therefore, can be introduced to the Court in a summary fashion. Petitioner 1605 Book Center, Inc., a business in New York City's Times Square area, sold sexually oriented books and magazines, operated a motion picture theater, and provided coin-operated "peep show" booths on its premises for patrons. In July 1980, following an audit of Petitioner's business, the New York State Department of Taxation and Finance issued to Petitioner a notice demanding sales and use taxes for the period March 1, 1976 through August 31, 1979, plus interest, totalling $160,185.08.

Among the assessments were claims for sales tax on the receipts from a viewing machine in which the patron, after entering a booth, deposits a quarter in a slot, permitting him to view a dancer through a glass or to speak to a woman on the other side of a glass partition through an intercom. (Record in New York Court of Appeals at R. 298-99)[2] The assessment was imposed under Section 1105

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[2] Hereafter, numbers preceded by "R" refer to pages of the Record on Appeal filed in the New York Court of Appeals.

(f)(1) of the New York Tax Law which requires that a sales tax be collected on any "admission charge" to a "place of amusement." No such tax had ever been imposed on money deposited in a machine. The only businesses assessed were those of the Petitioner, and its related companies, located in the Times Square section of New York City.

Procedural History

Petitioner filed a petition challenging these assessments in August 1980, specifically claiming, *inter alia,* that Petitioner's rights under the federal constitution were violated because of "[t]he selective enforcement of the sales tax against petitioner in violation of petitioner's rights under the First, Fourth, Fifth, Ninth and Fourteenth Amendments to the United States Constitution." (Petition to Tax Appeals Bureau dated August 1980 at 2; R. 561.)

A hearing on all of Petitioner's claims[3] before an Administrative Law Judge was ultimately held, but not until 1989. At the hearing, Petitioner introduced uncontroverted evidence in support of its claim that the assessment was being selectively enforced against it because of the nature and location of its business.

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[3] Petitioner's principal substantive claim involved an issue of state law only, namely, whether a coin-operated "peep show" is a "place of amusement" and the coins an "admission charge" subject to a sales tax under the New York Tax Law.

One of the Auditors Indicated That the City Was Out "To Get" the Sex Establishments in Time Square

Petitioner introduced the affirmation of Irving Adlerstein, a Certified Public Accountant, who for the previous 15 years had performed independent accounting services for Petitioner as well as for similar enterprises in Manhattan. (R. 403, 691) Petitioner expected to call Mr. Adlerstein as a witness but, as certified in a letter submitted by his doctor, Mr. Adlerstein was stricken with Lyme disease while the hearing was underway and confined to his home.[4] (R. 403) The Adlerstein affirmation stated that sometime during the early audit period – i.e., 1976-1979, a full decade before the time of the hearing – he spoke with Miguel Cruz, an examiner from the Department of Taxation and Finance. (R. 402-03, 691) Mr. Cruz said on that occasion that he did not believe the various forms of entertainment conducted by these enterprises were subject to a sales tax, but that there had been a sudden change of policy and a major drive was on "to get" these businesses. (R. 403, 691-92) He said the City was pushing to make cases against the adult entertainment businesses in the Times Square area. (R. 402-03, 692)

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[4] The Rules of Practice and Procedure of the New York State Tax Commission expressly provide that "[a]ffidavits may be received, for whatever value they may have, in lieu of oral testimony of the persons making such affidavits." *See* Title 20, Official Compilation of Codes, Rules and Regulations of the State of New York, Part 601.9(d) (1986). In addition, it is well-established under New York law that hearsay is admissible in an administrative hearing and it can form the basis for an Administrative determination. *See Gray v. Adduci*, 73 N.Y.2d 741, 742, 536 N.Y.S.2d 40, 41, 532 N.E.2d 1268 (1988).

No Other Coin-operated Amusement Devices in New York State Have Been Subjected to a Sales Tax

Petitioner called as a witness Dr. Charles Winick, a psychologist, who is an expert in the field of adult entertainment and has studied entertainment establishments throughout the United States and, particularly, in the Times Square area. (R. 315) His studies of that area have been sponsored by the City of New York, the Shubert Theater Organization, the Ford Foundation, the President's Commission on Pornography, and the New York City Office of Midtown Enforcement Project. (R. 287-295)

Dr. Winick testified that a survey of approximately 24 "peep show" machine establishments in Buffalo, Niagara Falls, Rochester, Syracuse and other major New York cities revealed that they have never been subjected to a sales tax. (R. 303-04) His survey also determined that amusement arcades located throughout Manhattan, in which there are coin-operated machines of all types, have never been assessed with a sales tax, nor had video-game parlors throughout New York City. (R. 303) The only coin-operated machines in New York State that have been subjected to a sales tax are those in the adult entertainment establishments located in Times Square.

Dr. Winick had conducted studies in the Times Square area for the past 20 years and had witnessed one campaign after another to drive adult entertainment establishments out of the Times Square area. (R. 315-316) During the audit period he had heard Mayor Abraham Beame announce publicly that "[w]e shut them down and we're going to shut them all down." (R. 318) He testified

that during the past decade the number of adult entertainment establishments had diminished and that only one-fifth of them have survived. (R. 319) This has been the result of aggressive, selective enforcement of various laws and ordinances against these businesses that "has not been applied to other kinds of establishments." (R. 319)

Dr. Winick had had conversations with Office of Midtown Enforcement personnel, who discussed their strategy with him and admitted that aggressive law enforcement was being selectively applied to the adult businesses in Times Square. (R. 319-20) They indicated that they had sent teams of building inspectors and fire inspectors into the adult establishments on a daily basis to hamper their operations. (R. 319-20)

Based on his experience, including his knowledge of the practices of the Office of Midtown Enforcement, it was Dr. Winick's opinion that the sales tax assessment against Petitioner was consistent with the larger effort which he had described as selective enforcement. (R. 320) His opinion was supported by the fact that no sales tax assessment had been brought anywhere else in the state against any other proprietors of coin-operated machines like those in this case. (R. 320)

"We Stop at Nothing to Put These People Out of Business" – Sidney Baumgarten, Head of the Midtown Task Force

Finally, Ralph Schwarz, an attorney, who represents adult entertainment establishments in the Times Square sector, testified that he had personally witnessed the

harassment campaign conducted by the City of New York.[5] (R. 379) This campaign involved unwarranted multiple arrests; the seizure of equipment from bookstores and theaters; the use of building violations to harass owners of the stores; and ultimately the "Use Group 15" strategy, i.e., the manipulation of local zoning ordinances by reassigning establishments that operated "peep shows" to a new "use group" barred from the Times Square area. (R. 380-86) Many of these selective measures were halted by federal injunctions.[6] (R. 380-81, 386)

Mr. Schwarz recalled that in the summer and fall of 1975 there were public pronouncements in the press and on radio and television that the City had formed a special unit whose avowed purpose was to drive the adult enterprises out of business. (R. 379) On November 13, 1975, he listened to a speech in which Sidney Baumgarten, head of the Midtown Enforcement Project, said, "We stop at nothing to put these people out of business." (R. 379) Mr. Schwarz testified that the New York City Buildings Department had engaged in illegal activity to drive the adult businesses out of the Times Square area, and that he was convinced it had joined forces with the Fire Department and the Health Department for the purpose of doing so. (R. 379, 394) In fact, the Office of Midtown

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[5] The New York City Department of Finance performs sales tax audits for the State of New York, and did so in this case, and thus the city personnel act as agents of the State.

[6] *See Black Jack Distributors, Inc. v. Beame*, 433 F.Supp. 1297 (S.D.N.Y. 1977); *Show World Center, Inc. v. Walsh*, 438 F.Supp. 642 (S.D.N.Y. 1975).

Enforcement Project said, in essence, that they had done exactly that. (R. 395)

Based on this history and his experience in representing clients in the Times Square area for 20 years, Mr. Schwarz was convinced that the New York sales tax was being selectively enforced against the adult entertainment businesses in Times Square to drive them out. (R. 387)

None of this proof was controverted by Respondent.[7] No witnesses were called to rebut or even dispute the evidence of selective enforcement presented by the Petitioner, nor was any neutral reason offered for the fact that only the businesses in the Times Square area were being assessed. And no attempt was made to call any auditor or official to challenge the evidence – including auditor Cruz's statement to Adlerstein – that the adult entertainment establishments were being assessed the sales tax because of the nature of their business.

The Decisions Below

In a written opinion filed after submission of post-hearing briefs, the Administrative Law Judge simply held: "Petitioner has not established that this audit was conducted for the purpose of harassing petitioner or in any way interfering with its right to conduct its business;

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[7] There was virtually no cross-examination of the Petitioner's witnesses with the exception of questions of Mr. Schwarz concerning whether the New York City Department of Finance ever put in writing that the sales tax was being selectively enforced against the adult entertainment establishments in Times Square. (R. 390) He had seen nothing in writing. (R. 390)

therefore its argument regarding selective enforcement of the Tax Law will not be addressed." (App. 78)

On Petitioner's appeal to the New York Tax Appeals Tribunal, Petitioner reasserted its selective enforcement claim, but that body held: "We agree with the Administrative Law Judge that petitioner has not established that this audit was conducted for purposes of harassing petitioner or in any way interfering with its right to conduct its business and, therefore, there is no reason to address petitioner's legal argument concerning selective enforcement." (App. 46)

Petitioner then commenced a proceeding in the Supreme Court of the State of New York, Appellate Division, Third Department, to review the Tax Appeal Tribunal's decision and annul the tax determination, requesting, *inter alia*, that the court "[d]eclare that the sales tax was selectively enforced against Petitioner." (Article 78 Petition at 11; R. 14) The court ultimately held that "the hearsay and conclusory evidence offered by petitioner is insufficient to make out a prima facie showing that petitioner was a victim of selective enforcement by respondents and, therefore, no hearing is required." (App. 13)

Petitioner next appealed to the New York Court of Appeals, again asserting that "[t]his sales tax is being selectively enforced against petitioner because of the nature of its business." (Petitioner's Brief in New York Court of Appeals at 54.) The Court affirmed without

expressly addressing Petitioner's selective enforcement claim.[8] (App. 1-8)

REASONS FOR GRANTING THE PETITION

This is the first case that we know of to ever reach this Court involving the selective enforcement of a tax against a business engaged in free speech activities protected by the First Amendment. Thus, it presents a unique issue never before examined by this Court. Selective enforcement claims based upon free speech rights have in the past arisen in the context of *criminal* prosecutions involving protests of one sort or another.[9]

But a commercial entertainment case, such as this, which involves the First Amendment rights not only of the exhibitor but also of a large audience, poses broader constitutional concerns because the curtailment of speech ranges further. Moreover, since this is not a criminal case and involves no prosecutorial discretion, the measure of proof to sustain a selective enforcement claim should not be as great as that in routine selective prosecution cases.

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[8] The Court did state: "We have considered appellant's other arguments and conclude that they are without merit or unpreserved." (App. 8) Since, as has been shown, Petitioner's selective enforcement claim was raised at every stage of the proceeding, and since Respondent did not contend in the New York Court of Appeals that the claim was unpreserved (*see* Respondent's Brief in New York Court of Appeals at 22-27), it must be presumed that the court found the claim to be without merit.

[9] *See, e.g., Wayte v. United States*, 470 U.S. 598, 608 (1985) (draft protest); *United States v. Ojala*, 544 F.2d 940 (8th Cir. 1986) (tax protest).

Therefore, we ask that the following rule be considered and adopted: when a person makes a colorable claim, in a noncriminal case, that a tax, or other law, is being selectively enforced in a way that impinges on the exercise of free speech, then the state bears the burden of establishing no invidious discrimination. There is a strong basis in the law for such a rule.

The reasons for granting certiorari and adopting the rule we propose must be examined against the backdrop of the First Amendment. In an unbroken series of cases extending over a long stretch of this Court's history, it has been held postulate that freedom of expression enjoys a very special place in our hierarchy of Constitutional values.[10] And, it is well established that free expression is "vulnerable to gravely damaging yet barely visible encroachments." *Bantam Books, Inc. v. Sullivan*, 372 U.S. 58, 66 (1963). This Court has stressed that "[a]ny system of prior restraints of expression comes to this Court bearing a heavy presumption against its Constitutional validity." *Id.*

Furthermore, the *form* of any prior restraint imposed upon the exercise of First Amendment rights is of no consequence. It is the *effect* that counts. In determining whether or not governmental action constitutes an

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[10] *New York v. P.J. Video*, 475 U.S. 868 (1986); *Walter v. United States* 447 U.S. 649 (1980); *Lo-Ji Sales, Inc. v. New York*, 442 U.S. 319 (1979); *Heller v. New York*, 413 U.S. 483 (1973); *Roaden v. Kentucky*, 413 U.S. 496 (1973); *Lee Art Theater, Inc. v. Virginia*, 392 U.S. 636 (1968); *Freedman v. Maryland*, 380 U.S. 51 (1965); *A Quantity of Books v. Kansas*, 378 U.S. 205 (1964); *Marcus v. Search Warrant*, 361 U.S. 717 (1961).

unlawful prior restraint, it is the substance that must be considered, not the form. *Near v. Minnesota*, 283 U.S. 697, 708 (1931); *Bantam Books, Inc. v. Sullivan*, 372 U.S. at 67; *Southeastern Promotions, Ltd. v. Conrad*, 420 U.S. 546, 552-54 (1975). This Court has also stressed, in other areas where there has been infringement of free speech, that the standards of proof must "be applied with scrupulous exactitude" when a person's rights under the First Amendment are at issue. *Zurcher v. Stanford Daily*, 436 U.S. 547, 564 (1978).

Governmental regulations cannot be applied selectively *because of* the exercise of First Amendment activities, *Arcara v. Cloud Books, Inc.*, 478 U.S. 697, 707 n. 4 (1986) (dictum); *Wayte v. United States*, 470 U.S. at 608. This principle, deeply rooted in our constitutional tradition, reflects a sound national policy of maintaining the integrity of the enforcement of the law with equality and even-handedness. If this even-handed proposition is to be given effect, and if selective enforcement claims are not to be routinely dismissed, this Court must establish special guidelines for assessing the evidence introduced in support of claims which involve the assertion of rights under the First Amendment.

When selective enforcement is employed against conduct protected by the First Amendment the constitutional concern is heightened.[11] Here, the selective enforcement

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[11] Petitioner makes no claim that it is exempt from taxation. It is the selective manner in which that tax law is being enforced that brings us to this Court. We recognize that the press or booksellers may not claim special protection from governmental regulations of *general* applicability simply by virtue of their First

of the sales tax against Petitioner is just as chilling as the methods used in a host of other cases decided by this Court in which the risk of prior restraints was evident and, as a consequence, this Court found such tactics to be unconstitutional.[12] Those who distribute adult materials are discouraged from doing so by selective taxation of this subversive nature – and it acts as an invalid restraint on the distribution of protected materia1.[13] *See Bantam Books, Inc. v. Sullivan*, 372 U.S. 58.

The broad rules for advancing claims of selective enforcement in routine criminal cases should be modified when applied to those cases involving free speech and the application of the tax laws. For example, in customary selective prosecution cases a grievant bears the heavy burden of proving both that he was treated disparately, i.e., others similarly situated have not been so treated, and that the disparate treatment was motivated by a discriminatory purpose, i.e., it was based on an unjustifiable standard such as race, religion or exercise of constitutional rights. *See Wayte v. United States*, 470 U.S. at 608;

Amendment protected activities. *See Minneapolis Star & Tribune Co. v. Minnesota Comm'r of Revenue*, 460 U.S. 575, 581 (1983)

[12] *Walter v. United States* 447 U.S. 649; *Lo-Ji Sales, Inc. v. New York*, 442 U.S. 319; *Roaden v. Kentucky*, 413 U.S. 496; *Lee Art Theater, Inc. v. Virginia*, 392 U.S. 636; *Freedman v. Maryland*, 380 U.S. 51.

[13] It is a matter of public record that over *$13,818,000* in sales taxes have been assessed against the Petitioner and its related companies. No other similarly situated businesses in New York have been subject to such assessments. It is hard to imagine what can be more chilling than a financial burden of such an enormity. A tax burden of this magnitude surely is onerous enough to drive any enterprise out of business.

see also McCleskey v. Kemp, 481 U.S. 279, 292 (1987); *Yick Wo v. Hopkins*, 118 U.S. 356, 373-74 (1886) (ordinance must not be applied "with an evil eye and an unequal hand").

At least one court has stated that the grievant "bears a very heavy burden" in demonstrating invidious purpose, *United States v. Greene*, 697 F.2d. 1229, 1235 (5th Cir. 1983), while another suggests that a *prima facie* case is made out by "evidence which created a strong inference of discriminatory prosecution," *United States v. Steele*, 461 F.2d 1148, 1153 (1972). These formulations, applicable for the most part to criminal cases, suggest that the one claiming selective enforcement must not only prove his claim but must do so by at least clear and convincing evidence.

But since "[i]t is appropriate to judge selective prosecution claims according to ordinary equal protection standards," *United States v. Wayte*, 470 U.S. at 608, the heightened burden that courts appear to place on persons claiming selective enforcement in criminal cases is unjustified in the context of a case which implicates free speech rights and the selective application of a sales tax. And this is particularly so in cases other than *criminal* prosecutions, where unique considerations require greater deference to prosecutorial discretion. *See id.* at 607.

In a criminal case, there is a *presumption* that the prosecution is undertaken in good faith. *United States v. Ojala*, 544 F.2d 940; *United States v. Falk*, 479 F.2d 616, 620 (7th Cir. 1973). And, in criminal prosecutions there is a

large measure of discretion bestowed on government officials for a whole host of reasons. However, that presumption and the exercise of prosecutorial discretion do not pertain to the enforcement of a tax where the law is expected to be applied uniformly – and where there is normally no excuse for selective assessment. In this case, it is undisputed that no other entities similarly situated were even *assessed!* The only businesses assessed with this sales tax were those of the Petitioner, and its related companies.

This Court has recognized that discriminatory enforcement of laws in a manner that curtails First Amendment rights is especially pernicious:

> It is clearly unconstitutional to enable a public official to determine which expressions of view will be permitted and which will not or to engage in invidious discrimination among persons or groups whether by the use of a statute providing a system of broad discretionary licensing power or, as in this case, the equivalent of such a system by selective enforcement of an extremely broad prohibiting statute.

Cox v. Louisiana, 379 U.S. 536, 557-58 (1965).

Moreover, it is well recognized that when the State chooses to enforce a law against only those individuals who have exercised their First Amendment rights by, for example, speaking out against government policies or expressing an unpopular view of society, an informal system of prior restraint is created. And in that circumstance, there exists a strong *presumption* against the constitutional validity of such a restraint. *New York Times Co.*

v. United States, 403 U.S. 713 (1971); *Bantam Books, Inc. v. Sullivan*, 372 U.S. 58; *Near v. Minnesota*, 283 U.S. 697.[14]

Here Petitioner presented, first, substantial evidence of the widespread, enduring and aggressive efforts by local governmental agencies generally to drive adult entertainment establishments out of the Times Square area; second, specific evidence that a tax examiner involved in the very assessment at issue had stated that he believed the tax was not applicable to Petitioner's business, but that there was a major drive on "to get" these businesses, i.e., to make cases against the adult entertainment businesses in the Times Square area; and, third, evidence that a sales tax on coin-operated devices like Petitioner's "peep shows" was being assessed nowhere else in the state.

If, in the face of this unrebutted evidence, the four state tribunals that reviewed Petitioner's selective enforcement claim gave as short shrift to it as they did – treating it dismissively as insufficient, conclusory or hearsay – then the question is what more was Petitioner required to show and how must it be shown? Clearly, such indifference to Petitioner's complaint warrants a

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[14] In the Sixties, prior restraint was found in the massive confiscation of books. *A Quantity of Copies of Books v. Kansas*, 378 U.S. 205; *Marcus v. Search Warrants*, 367 U.S. 717. In the Seventies, it was seen in the unauthorized seizure of magazines and films. *Heller v. New York*, 413 U.S. 483; *Roaden v. Kentucky*, 413 U.S. 496; *Lo-Ji Sales, Inc. v. New York*, 442 U.S. 319. Today, we are faced with the spectacle of intentional discriminatory enforcement by selective application of the tax laws to those who exhibit films or performances deemed distasteful by some public officials or members of society.

reassessment of the standard to be applied in judging such an important federally protected right. And, this is particularly so when the consequences to free speech are so far reaching.

When a person makes a colorable claim that the selective enforcement of a tax impinges upon the exercise of First Amendment rights, the burden should then shift to the State to establish that there is no invidious discrimination. Moreover, where the State refuses to present *any* evidence or reasons justifying the selective enforcement, then there should be a *presumption* that the enforcement is unlawful. Thus, in this case, when the Petitioner produced evidence that the New York Sales Tax was being enforced against it in a selective manner, the State was obliged to establish a lawful basis for the discriminatory enforcement. Its failure to do so should have resulted in an invalidation of the tax assessment.

To suggest that all the carefully constructed procedures that have governed prior restraints concerning others engaged in free speech activities somehow don't apply when dealing with the selective enforcement of a tax against a provider of entertainment protected by the First Amendment makes no sense at all. The basic intuition underlying all of these free speech cases is that the State cannot use its powers in any discriminatory way to interfere with the public's access to all forms of legal entertainment. The selective enforcement of the tax laws carries with it a restraining force every bit as onerous as the State's conduct in these other cases.

No one would doubt that if the state selectively imposed a tax on the *New York Times* or the *Washington*

Post, it would have a chilling effect upon the distribution of those newspapers. The state would have to establish that there was justification for such action. Petitioner is entitled to the same protection afforded the *New York Times* or the *Washington Post* because the security of the First Amendment cannot be made to depend upon the refinement of the entertainment provided by the entity taxed.

It bears repeating that here the State's attorney flatly refused to offer any explanation concerning why it was that Petitioner is the only establishment being subjected to the sales tax. Since the State, in this case, elected to "stonewall" and make absolutely no showing of justification, the prosecution of the sales tax should have been dismissed. To suggest that a State be able to stand mute in the face of such a substantial claim of selective enforcement is unthinkable and is alien to our most basic constitutional disciplines.

And finally, the "hearsay" grounds for dismissing Petitioner's claim[15] is particularly perplexing since, as is generally the rule, it is well-established under New York law that not only is hearsay admissible in an administrative hearing, but it can be the basis for an administrative determination, *see Gray v. Adduci*, 73 N.Y.2d at 742, 536 N.Y.S.2d at 41, 532 N.E.2d 1268, and the Rules of Practice and Procedure of the New York State Tax Commission expressly provide that "[a]ffidavits may be received, for

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[15] The tax examiner's statement to Petitioner's accountant appears to fall within the "statement against interest" exception to the hearsay rule, since he is an agent of the Department of Taxation and Finance.

whatever value they may have, in lieu of oral testimony of the persons making such affidavits." *See* Title 20, Official Compilation of Codes, Rules and Regulations of the State of New York, Part 601.9(d) (1986).

Courts need clearer guidance regarding the standard of proof, the burden of proof and the nature of the proof required to sustain a claim of selective enforcement under the equal protection clause, in a non-criminal case, where the effect of the enforcement is to curtail the exercise of the First Amendment rights of an entertainment exhibitor and the audience. The Court should therefore grant certiorari to provide this guidance.

CONCLUSION

The petition for a writ of certiorari should be granted.

Dated: New York, New York
May 13, 1992

Respectfully submitted,

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[OPINION OF THE NEW YORK COURT OF APPEALS]

STATE OF NEW YORK

COURT OF APPEALS

In the Matter of 1605 Book Center Inc.,

Appellant,

v.

Tax Appeals Tribunal of the State of New York et al.,

Respondents.

OPINION

Herald Price Fahringer, for appellant.
John McConnell, for respondents.

BELLACOSA, J.:

Article 28 of the Tax Law requires a sales tax to be paid on "any admission charge" for use of "any place of amusement". The issue is whether Tax Law §1105(f)(1) permits the State taxing authority to collect a sales tax on receipts derived from patrons depositing coins in peep show booths to view or converse with live entertainers. We granted leave to appeal and agree with the Appellate Division that the gross receipts for admission to this place of amusement are taxable.

During the tax period at issue, appellant 1605 Book Center, Inc., conducted a business in New York City's Times Square area. It sold sexually oriented books and magazines, operated â motion picture theater, and provided live peep show booths on its premises for patrons to enter and activate by the deposit of a coin.

In July 1980, following an audit, the State Division of Taxation issued a Notice of Determination and Demand for Payment of sales and use taxes due for the period March 1, 1976 through August 31, 1979, assessing tax due of $141,686.11 plus interest. The audit report indicated that four categories of sales were included in the audit, including those for sales taxes on two types of live peep shows. The first included those available by coin-operated machines, in private booths that surrounded a stage on which nude or partially nude females performed. The other venue, known as the "fantasy booth," also functioned with a coin deposited in a private booth, allowing a patron to converse with a scantily-dressed woman. In both booths, the patron was separated from the performer by a glass partition which was covered by a curtain or screen. The curtain parted for a set time only after the patron deposited a coin into the machine.

Petitioner challenged the tax assessment. Following a hearing, an Administrative Law Judge granted the petition in part, but, as pertinent to this proceeding, found that revenues derived from the live peep shows and fantasy booths were subject to sales and use taxes under Tax Law §1105(f)(1). On appeal, the Tax Appeals Tribunal denied the exemption asserted by appellant, upheld the tax determination in its entirely, and rejected appellant's claim that it had been subjected to selective enforcement.

Petitioner commenced this CPLR article 78 proceeding to annul the determination, asserting that this case represents an unwarranted extension of Tax Law §1105(f)(1). The Appellate Division confirmed the determination and dismissed the petition (*Matter of 1605 Book*

Center, Inc. v Tax Appeals Tribunal, 188 AD2d 694). We now affirm.

Tax Law §1105(f)(1) provides, in pertinent part, that a sales tax should apply to "*[a]ny admission charge* where such admission charge is in excess of ten cents to or *for the use of any place of amusement* in the state, * * * " (emphasis added). Section 1105(f)(1) specifically excludes from the sale tax, admission charges

> to race tracks, boxing, sparring or wrestling matches or exhibitions which charges are taxed under any other law of the state, or dramatic or musical arts performances, or motion picture theaters, and except charges to a patron for admission to, or use of, facilities for sporting activities in which such patron is to be a participant, such as bowling alleys and swimming pools.

The term "place of amusement" is defined by Tax Law §1101(d)(10) as "[a]ny place where any facilities for entertainment, amusement, or sports are provided", which includes without limitation a "theater of any kind, concert hall, opera house or other place where performances are given" (20 NYCRR 527.10[b][3]). The term "admission charge" is defined in Tax Law §1101(d)(2) as "[t]he amount paid for admission, including any service charge and any charge for entertainment or amusement or for the use of facilities therefor". Appellant insists that the booths are not places of amusement but devices such as jukeboxes and video games. The question devolves to one of pure statutory interpretation and analysis, determinable only on accurate apprehension of legislative expression and intent.

What, then, is the expressed and intended scope of Tax Law §1105(f)(1)? The Court's cardinal function in interpreting any statute should be to " 'attempt to effectuate the intent of the Legislature, and where the statutory language is clear and unambiguous, the courts should construe it so to give effect to the plain meaning of the words used' " (*Doctors Council v New York City Employees' Retirement Sys.*, 71 NY2d 669, 674-675 *quoting Patrolmen's Benevolent Assn. v City of New York*, 41 NY2d 205, 208). Thus, the "resort to extrinsic matter is inappropriate when the statutory language is unambiguous and the meaning unequivocal" (*Sega v State of New York*, 60 NY2d 183, 191). When, however, due to nuances and variations of human language, reasonable minds differ as to the perceived meaning of the words used, the Court resorts to rules of construction and interpretation of the enactment with reference to the objectives sought to be achieved and the contextual spirit and purpose of its enactment (*see, Matter of Petterson v Daystrom Corp.*, 17 NY2d 32, 38).

Ambiguity in tax statutes should, of course, "be construed in favor of the taxpayer and against the taxing authority, and the burdens they impose are not to be extended by implication" (*Matter of American Cyanamid & Chem. Corp. v Joseph*, 308 NY 259, 263; *Quotron Systems, Inc. v Gallman*, 39 NY2d 428, 431). Correspondingly, tax statutes should be construed to insure the collection of all designated taxes where a supportable theory can be found (*see, County of Nassau v Lincer*, 254 App Div 760, *affd* 280 NY 662; *see also*, McKinney's Cons Laws of NY, Book 1, Statutes §313). As often happens, generalities of construction axioms neutralize one another, and courts

inevitably return to the precise language of the enactment in an effort to give a correct, fair and practical construction that properly accords with the discernible intention and expression of the Legislature (3A Singer, Sutherland Statutory Construction §66.01, at 11 [4th ed.]).

Once again, we note that the critical words here are "admission charge" and "place of amusement." These terms are expansively defined and unqualifiedly intoned, and Tax Law §1101 does not limit their sweep in the way appellant urges. Thus, without resorting to extrinsic materials, the Legislature's plain expression captures appellant's admission receipts derived from this form of amusement in these places.

The facts are uncontroverted that the mechanics for utilizing the live peep shows and fantasy booth are essentially the same. The patron enters a place, the booth, with a door that closes behind the patron. After entering the booth, the patron could place coins in a slot which raises a screen or curtain and enables the patron to view a live performance or converse with a scantily clad performer. A light illuminated outside the booth indicates the booth is in use. The booth provides the patron with privacy, screens out noise and light, and ensures that each patron pays a separate admission fee. The length of amusement time is controlled exclusively by the number of coins deposited by the patron in the mechanical slot which controls movement and placement of the screen or curtain. The booth thus qualifies as a place of amusement and the coin deposit qualifies as an admission charge within the contemplation and embrace of the taxing statute.

Notably, there can be no doubt that the sales tax would apply if patrons viewed the same live performance in the company of other audience members in a theater (*see*, 20 NYCRR 527.10[b][3]). The booths are factually not taxably distinguishable from a usual theater except for the element of privacy. Accordingly, the fee paid is an admission charge to a place where entertainment is provided. That the charge is collected after the patron enters the booth by means of a coin operated device is not of determinative legal significance.

Although resort to statutory rules of construction is unnecessary in view of our plain language analysis of the statute, we discern additional support for the taxing authority's position in that complementary approach as well. Section 1105(f)(1) excludes certain admission charges to specific places of amusement from the broad scope of the taxing statute. Live peep show booths and fantasy booths are not exempted. Thus, the interpretative maxim, the expression of one is the exclusion of others, supports the conclusion that what was omitted from the exemptions was not intended to be excluded from the otherwise comprehensive taxable sweep of section 1105(f)(1) (*see, Golden v Koch*, 49 NY2d 690; *see also*, McKinney's Cons Laws of NY, Book 1, Statutes, §240).

Fairland Amusements v State Tax Comm. (66 NY2d 932) does not support a contrary result. The situation in *Fairland* is distinguishable because no comparable threshold ambiguity exists in the present case and that case does not erect a general threshold ambiguity around the phrase "place of amusement". Moreover, the nature of the entertainment at issue – privately viewing or speaking

with live performers for sexual amusement – is not comparable to the use of mechanical devices, such as amusement rides. At bottom, appellant's building, booths and physical spaces are not at all like fairgrounds.

It is also clear that the live peep shows differ from mechanical "devices for amusement" in that the entertainment places at issue here involve the viewing and interacting with a live performer, which presents a spontaneous, human feature not found in coin operated electronic solo entertainment devices. In essence, these commercial transactions reflect the collection of an admission charge for paying customers to be amused by live sex shows and "fantasy" experiences. To treat the charge as one imposed for the use of a "device for amusement," as appellant suggests, would contradict the core reality of these human exchanges and taxable transactions (*contrast, Bathrick Enters. v. Murphy*, 27 AD2d 215, *affd* 23 (NY2d 664).

Appellant's further reliance on a string of additional cases is also misplaced (*see, Outdoor Amusement Bus. Assn. v State Tax Comm.*, 84 AD2d 950, *revd on dissenting mem below* 57 NY2d 790; *United Artists Theatre Circuit, Inc. v State Tax Comm.*, 52 NY2d 1013; *Matter of Hospital Tel. Sys., Inc. v State Tax Comm.*, 36 NY2d 746, *affg* 44 AD2d 271). Each of those cases presented situations factually and significantly distinct from this one. Thus, they do not support the view that the sales tax at issue was invalidly imposed.

Finally, we reject appellant's argument that the Department's tax treatment of booths in which films are activated by a mechanical device is inconsistent with its

treatment of live peep show booths. As the concurring Justice at the Appellate Division correctly observed, the two transactions are sufficiently distinguishable to allow differential tax treatment that may not be judicially countermanded (*Matter of 1605 Book Center, Inc. v Tax Appeals Tribunal*, 188 AD2d 694, 697, [Levine, J., concurring]).

We have considered appellant's other arguments and conclude that they are without merit or unpreserved.

Accordingly, the judgment of the Appellate Division should be affirmed, with costs.

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Judgment affirmed, with costs. Opinion by Judge Bellacosa. Chief Judge Kaye and Judges Simons, Smith and Ciparick concur. Judges Titone and Levine took no part.

Decided February 15, 1994

**Order of the Appellate Division,
Third Department,
Dated October 3, 1992**

Supreme Court – Appellate Division

Third Judicial Department

Decided and Entered: December 3, 1992

In the Matter of 1605 BOOK CENTER INC.,

Petitioner,

v

TAX APPEALS TRIBUNAL OF THE STATE OF NEW YORK et al.,

Respondents.

MEMORANDUM AND JUDGMENT

Calendar Date: September 14, 1992

Before: Levine, J.P., Mercure, Mahoney, Casey and Harvey, JJ.

Lipsitz, Green, Fahringer, Roll, Salisbury & Cambria (Herald Price Fahringer of counsel), New York City, for petitioner.

Robert Abrams, Attorney-General (John McConnell of Counsel), Albany, for Commissioner of Taxation and Finance of the State of New York, respondent.

Harvey, J.

Proceeding pursuant to CPLR article 78 (initiated in this court pursuant to Tax Law § 2016) to review a determination

of respondent Tax Appeals Tribunal which sustained a sales and use tax assessment imposed under Tax Law articles 28 and 29.

In 1980 the Audit Division of the Department of Taxation and Finance determined that petitioner, a purveyer of various forms of adult entertainment in the Times Square area of New York City, owed $141,686.11 in sales and use taxes plus interest for the period between March 1, 1976 through August 31, 1979. Included among the assessments were claims for sales taxes on two types of live peep shows operated by petitioner. One of these, called "live peep shows", involved a coin-operated device, contained within a private booth, which allowed the patron to view from behind a glass partition a nude or partially nude woman perform a dance. The other applicable entertainment, called a "fantasy booth", also involved a coin-operated private booth and this allowed a patron to have a conversation with a woman dressed in abbreviated attire located on the opposite side of the glass partition.[1] Petitioner challenged the Audit Division's adverse assessment determination and a hearing before an Administrative Law Judge (hereinafter ALJ) was ultimately held. The ALJ partially granted the

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[1] As gleaned from the hearing testimony and the parties' stipulation, the live peep shows and fantasy booth worked as follows. The patron entered a booth, for which no fee was paid, and a coin was inserted into a machine. A screen then lifted exhibiting a glass partition behind which nude or partially clad women performed on a stage, which was surrounded by the booths. The women paid more attention to those booths where the curtains were lifted. In the fantasy booth, the patron could speak to a woman via an intercom system. Patrons could not remain in the booth if coins were not inserted in the machine, and a light went on outside the booths when they were being used by patrons.

petition but, as pertinent to this proceeding, found that revenue from the live peep shows and fantasy booths were subject to sales and use taxes.

Both petitioner and respondent Commissioner of Taxation and Finance filed a notice of exception to the ALJ's determination with respondent Tax Appeals Tribunal. After argument, the Tribunal denied the exceptions of petitioner and respondent and upheld the ALJ's determination in its entirety. The Tribunal found that revenues from live peep shows and fantasy booths were subject to sales tax because "patrons entered a physical place, the booth, and paid a fee which provided them with a private space from which to watch the peep show. In short, each patron paid an admission charge to a place of amusement" (*see*, Tax Law § 1101 [d] [2], [10]; § 1105 [f] [1]). Petitioner thereafter commenced this CPLR article 78 proceeding in this court seeking review of the Tribunal's determination.

We confirm. Petitioner, citing the language of Tax Law § 1105 (f) (1) and various cases, argues that because jukeboxes, video games and other coin-operated amusement devices have been found to be outside the scope of the Tax Law (*see, e.g., Matter of Hospital Tel. Sys. v New York State Tax Comm.*, 44 AD2d 271, *affd* 36 NY2d 746; *Bathrick Enters. v Murphy*, 27 AD2d 215, *affd* 23 NY2d 664), live peep shows and fantasy booths, which are allegedly similar to these devices, should also be found not subject to the sales tax. According to petitioner, no meaningful distinction exists between live peep shows and movie peep shows, which respondent stipulated are not taxable. We cannot agree with these contentions.

Tax Law § 1105 (f) (1) mandates that a tax be collected on an "admission charge * * * for the use of any place of amusement". An admission charge is defined as an "amount paid for admission, including any service charge and any charge for entertainment or amusement or for the use of facilities therefore" (Tax Law § 1101 [d] [2]). A place of amusement is defined as "[a]ny place where any facilities for entertainment, amusement, or sports are provided" (Tax Law § 1101 [d] [10]). Here, each booth relevant in this case "was a physical place which could be entered to watch a show for amusement". Therefore, the Tribunal properly held that revenues from live peep shows and fantasy booths are "admission charge[s]" to a "place of amusement" (Tax Law § 1105 [f] [1]; *see, Fairland Amusements v State Tax Commn.*, 110 AD2d 652, 954 [Mikoll, J., dissenting], *revd* 66 NY2d 932).

The booths involved here employing live female entertainment were clearly distinguishable from coin-operated jukeboxes, bowling games and other mechanical devices located in restaurants, taverns and other similar places. While petitioner is correct in noting that both movie peep shows and the live shows at issue here both require booth users to deposit coins that set in motion a mechanical apparatus which raises a screen to permit the entertainment, in the live shows the entertainment itself does not consist of the mechanical device which is set in motion by the coins. Instead, the entertainment consists of the performance by an entertainer viewed by one or more patrons in a shared entertainment space. Although patrons do not pay a fee to enter the booths themselves, they access live entertainment by inserting a coin into a machine. The booths afford privacy but are part of the amusement facility itself, which also consists of a stage and live performers. As a result, when the

live peep shows are considered in all their aspects, the only conclusion to be drawn is that the live peep shows and fantasy booth shows are places of amusement under the Tax Law (*see, Matter of Wien v. Murphy*, 28 AD2d 222, 225, *lv denied* 22 NY2d 646) and the charges for their use are essentially a fee for use of petitioner's entertainment facilities (*see, Outdoor Amusement Business Assn. v. State Tax Commn.*, 84 AD2d 950, 952, *revd on dissenting mem below* 57 NY2d 790).

Petitioner's remaining arguments have been considered and rejected. Despite petitioner's contentions otherwise, the hearsay and conclusory evidence offered by petitioner is insufficient to make out a prima facie showing that petitioner was a victim of selective enforcement by respondents and, therefore, no hearing is required (*see, Matter of Feigman v. Klepak*, 62 AD2d 816, 819).

Mercure, Mahoney and Casey, JJ., concur.

Levine, J.P. (concurring).

I concur in the resolution of the issues discussed in the majority's decision. I wish to address briefly, however, the additional issue of whether the determination of the Tax Appeals Tribunal is objectionable, under *Matter of Field Delivery Serv.* (*Roberts*) (66 NY2d 516), as an inconsistent treatment of essentially the same transactions, in not imposing an admission charge sales tax on petitioner's charges for viewing movies in its booths, while at the same time assessing that tax on the charges for viewing nude dancing, or viewing or speaking to a partially nude woman from the same or similar booths. In the case of the viewing of a movie in one of petitioner's booths, the patron deposited a coin or token in a slot which activated a mechanical movie-showing device. On the other hand, with respect to the other two

forms of entertainment offered from the booths, the patron deposited a coin or token in a slot activating a device to raise a screen or curtain enabling the patron to watch (or participate in) a live performance.

Thus, the charges for activating the mechanical movie-showing device in the booths at petitioner's establishment shared a salient (and dispositive) feature with the coin-operated music-playing devices held not subject to the admissions charge sales tax in *Bathrick Enters. v Murphy* (27 AD2d 215, *affd* 23 NY2d 664). As described above, however, this feature was absent in the case of the charges with respect to the live performances accessible from the booths. Because this distinction affords a rational basis for the differential treatment of the charges in connection with the live performances at petitioner's establishment, I find no violation of the rule enunciated in *Matter of Field Delivery Serv.* (*Roberts*) (*supra*). I therefore join in confirming the Tribunal's determination.

ADJUDGED that the determination is confirmed, without costs, and petition dismissed.

Decision of the Tax Appeals Tribunal

STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petition of 1605 BOOKCENTER, INC. for Revision of a Determination or for Refund of Sales and Use Taxes under Articles 28 and 29 of the Tax Law for the Period March 1, 1976 through August 31, 1979.	DECISION DTA No. 800121

Petitioner 1605 Bookcenter, Inc., c/o C & F Merchandise Company, 303 West 42nd Street, New York, New York 10036 and the Division of Taxation each filed an exception to the determination of the Administrative Law Judge issued on May 17, 1990 with respect to petitioner's petition for revision of a determination or for refund of sales and use taxes under Articles 28 and 29 of the Tax Law for the period March 1, 1976 through August 31, 1979. Petitioner appeared by Lipsitz, Green, Fahringer, Roll, Salisbury & Cambria (Herald Price Fahringer, Esq., of counsel). The Division of Taxation appeared by William F. Collins, Esq. (Michael B. Infantino, Esq., of counsel).

Both parties filed briefs on exception. Oral argument, at the request of the parties, was heard on January 30, 1991.

After reviewing the entire record in this matter, the Tax Appeals Tribunal renders the following decision.

Issues

I. Whether petitioner maintained and made available to the Division of Taxation adequate and complete books and records from which the exact amount of tax due could have been determined.

II. Whether, if adequate books and records were not maintained, the test period markup audit of petitioner's bookstore sales was reasonable.

III. Whether petitioner's receipts from the sale of certain publications were exempt from sales tax under section 1115(a)(5) of the Tax Law because they were receipts from the sale of periodicals.

IV. Whether charges imposed by petitioner for the viewing of live performances through a coin-operated apparatus were subject to sales tax.

V. Whether charges imposed by petitioner for admission to a theater where motion pictures and live performances were shown were shown were subject to sales tax.

VI. Whether the sales tax audit was conducted in a discriminatory manner or for the purpose of curtailing petitioner's First Amendment rights.

Findings of Fact

We find the facts as determined by the Administrative Law Judge and as stipulated to by the parties, except

for the first paragraph of finding of fact "5" which has been modified. The Administrative Law Judge's findings of fact, the stipulation and the modified finding of fact are set forth below.

On July 21, 1980, the Division of Taxation issued to petitioner, 1605 Book Center, Inc., a Notice of Determination and Demand for Payment of Sales and Use Taxes Due for the period March 1, 1976 through August 31, 1979, assessing tax due of $141,686.11 plus interest. No tax was assessed for the period September 1, 1976 through August 31, 1977.

Petitioner operated a commercial establishment in New York City's Times Square area. It was in the business of selling books, magazines, newspapers and novelty items, operating a theater where movies were exhibited and live performances were given, and providing "peep" shows. Its entire business was sexually oriented and all materials and performances offered to its patrons were sexually explicit.

An audit of 1605 began in or around May 1979. By letter dated May 7, 1979, the Division informed petitioner that a field examination of petitioner's books and records for the period March 1, 1976 through February 28, 1979 had been scheduled for May 14, 1979. The letter stated: "All books and records pertaining to your Sales Tax liability for the period under audit should be available. This would include journals, ledgers, sales invoices, purchase invoices, cash register tapes, exemption certificates, etc. and all Sales Tax records." The following books and records were made available by petitioner: sales tax returns and related worksheets, Federal income tax

returns and related worksheets, a sales journal, a purchases journal, some purchase invoices, and a general ledger. These records were judged to be in good condition.

Petitioner's general ledger showed gross receipts broken down into three categories: taxable [bookstore], nontaxable [bookstore] and vending machines. The auditor was informed that petitioner considered one-third of its bookstore sales to be taxable. All other receipts from all other sources were deemed by petitioner to be nontaxable. None of the auditors who participated in this audit were available to testify, and it is not possible to determine from the audit documents the exact nature of the charges included in each of the three categories shown in the general ledger. The Field Audit Report indicates that four categories of sales were included by the Division under the general heading "vending machines and other income": (1) sales income from live burlesque shows; (2) sales income from live peep shows; (3) sales income from vending machines; and (4) sales income from film viewers. All of these receipts were determined by the Division to be subject to sales tax. Total vending machine and other receipts as shown in petitioner's general ledger were $1,577,592.32, with a tax due on that amount of $126,207.39.

We modify the first paragraph of finding of fact "5" of the Administrative Law Judge's determination to read as follows:

> The Division performed a test period markup audit of petitioner's bookstore sales. The audit report indicates petitioner agreed to a test period audit. The narrative portion of the

> field audit report provided only a minimal description of the audit methodology employed, however, the audit workpapers were detailed and did demonstrate the method used.[1]

The test period selected was June 1978. Petitioner supplied invoices from two suppliers: Model Distributors and Century Sales Company.

The auditor listed each invoice on a columnar sheet by date, invoice number and the total amount of each invoice. A fourth column was headed "taxable purchases". Publications with the following titles were deemed to be nontaxable purchases: Advocate, Screw, Pleasure, Hook, Unique, Swing, Black and several publications identified only by initials. All other publications were deemed taxable, including publications identified on the invoices only as magazines, comics or by order number or title. Those publications deemed nontaxable were not included in the markup test figures. Century invoices showed only two items, dolls and unspecified magazines; the former were films purchased for use in the film viewing booths and for sale in the bookstore.

The Model invoices generally showed a "cover price", quantity, unit purchase price, and total purchase

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[1] The first paragraph of finding of fact "5" of the Administrative Law Judge's determination read as follows:

> "The Division performed a test period markup audit of petitioner's bookstore sales. The narrative portion of the field audit report provided only a minimal description of the audit methodology employed; however the audit workpapers were detailed and did demonstrate the method used."

We modified this finding of fact to fully reflect the record.

price for each item listed. The auditor applied the cover price to the number of items purchased to calculate total taxable sales of each item. Taxable sales of each item were totaled on each invoice and entered on the auditor's worksheet as "taxable at selling". The category was referred to as audited taxable sales. Where a cover price was not shown, the auditor marked up purchases on the Model invoices by 50 percent to determine the selling price. This percentage was obtained from an individual identified in the record only by name. Total purchases shown on the Century invoices were marked up 100 percent to determine a selling price. The basis for this markup percentage is not in the record.

Both Model and Century issued credit invoices for returned items. Amounts on the credit invoices were subtracted from total purchases and taxable purchases. For the purpose of determining audited taxable sales on returned items, total credit given was marked up 66 percent on Model invoices and 100 percent on Century invoices. Using this method the auditor determined that total purchases from Model were $6,952.42; taxable purchases were $4,847.34 and audited taxable sales were $7,916.60. From the Century invoices, total purchases were $5,009.95 (including a shipping and handling charge of $6.20), taxable purchases were $5,003.75, and audited taxable sales were $10,007.50. The auditor determined that petitioner purchased some films for use in its 46 film viewing machines, rather than for resale, and an adjustment was made to reflect this fact. After this adjustment was made, total purchases were determined to be $11,962.37, taxable purchases were determined to be $8,471.05, and audited taxable sales were determined to

be $15,164.10. Taxable purchases were divided by total purchases to calculate a taxable ratio of 70.81 percent. The auditor also calculated a markup of 79.01 by subtracting taxable purchases from audited taxable sales and dividing the result by audited taxable sales.

Additional taxable bookstore sales were determined by applying the taxable ratio to total purchases as shown in petitioner's records to determine audited taxable purchases. The markup percentage of 79.01 was applied to audited taxable purchases to calculate audited taxable sales of $406,487.00. An error rate of .9084 was determined from a mathematical comparison of reported taxable sales to audited taxable sales. Application of the error rate to reported taxable sales yielded additional taxable sales of $193,484.00 with a tax due on that amount of $15,478.72. No tax was assessed for the period June 1, 1976 through November 30, 1977.

As an adjunct, or more likely a preliminary, to the markup test, the auditor prepared a schedule, segregating purchases shown on the June 1978 invoices into four categories: papers, pocket books, magazines and novelties. The publications placed in the category of "papers" were the same as those determined to be nontaxable in the markup test. Publications identified only as magazines or comics were placed in the category magazines. Publications clearly identified as books, those having a cover price of less than three dollars and those identified only by order number, were classified as pocket books. All other publications were classified as magazines. In the markup test audit, all magazines were deemed taxable.

When conducting a test period audit of a bookstore selling sexually explicit materials, the Division currently instructs auditors to examine each publication on sale during the test period, to record the title of the publication and some information about the contents, and to indicate whether the publication is issued periodically. There is no evidence in the record that this procedure was followed here.

Petitioner's business is no longer in operation. The only witness who was on the premises of 1605 during the audit period was Dr. Charles Winick, who was qualified as an expert in the field of so-called "adult entertainment". Dr. Winick visited 1605 in 1978 and 1979. He testified that the mechanics for observing a peep show movie, a live peep show and a private show were essentially the same. The patron entered a booth with a door that could be closed behind him. He placed coins in a slot which caused a screen or curtain to rise and enabled him to view a show of some sort, either live or on film. The booth provided the patron with privacy, screened out noise and light and ensured that each patron paid a separate charge for viewing. When coins or tokens were placed in the slot, a light went on outside the booth to indicate that the booth was in use. The length of the patron's viewing time was controlled by the number of tokens he placed in the slot. When his time ran out, the screen or curtain came down, and the patron exited the booth.

Dr. Winick personally observed a theater located on the second floor of 1605. The theater was described as being approximately 15 feet by 20 feet and large enough to hold about 50 patrons. The movies shown at that time

were generally feature length pornographic films such as "Deep Throat" and "Behind the Green Door". The films were shown continuously from approximately noon until 11:00 P.M., interspersed by live performances of approximately 15 to 20 minutes in length.

At the request of petitioner's counsel, Dr. Winick conducted a survey in 1978 of publications sold by petitioner. He examined every publication in a magazine format, identifying its contents, format, publisher, date of publication, and evidence of serial publication such as a volume number, issue number and year. He inspected 351 publications and found only 29 that lacked evidence of serial publication. The publications he examined typically contained pieces of fiction and separate articles on a variety of topics.

Petitioner offered the testimony of Scott Wexler, the comptroller since 1985 of C & F Merchandising, a holding company for 1605 and other affiliated companies, to describe the accounting methods and procedures in effect during the audit period. Mr. Wexler's testimony was based on his familiarity with petitioner's accounting system and procedures and conversations with persons employed by petitioner during the audit period. He stated that receipts from peep shows were not segregated according to the type of entertainment being provided because all peep show receipts were considered to be nontaxable. The peep show apparatus included a meter which registered the number of coins placed in the receptacle. Approximately twice a week, an employee opened the coin receptacles, collected the monies inside, read the meters and entered the meter reading for each individual apparatus on a columnar sheet. The meter readings were

used as an internal control. After the monies collected were verified against the meter readings, the sheets were discarded. According to Mr. Wexler, the category in the general ledger entitled "vending machines" included receipts from the peep shows and for the theater.

Mr. Wexler testified that the bookstore used a cash register which produced a tape. The tapes were kept for at least three years. No tapes were produced at hearing. According to Mr. Wexler, petitioner and its affiliated companies regularly perform their own tests to determine what portion of their bookstore sales are subject to sales tax. Petitioner estimated that one-third of its bookstore sales were taxable based on such a test.

Mr. Wexler performed his own calculations to estimate gross receipts from the different types of peep shows.

Total revenue from all operations, taken from petitioner's books and records, was stated to be $1,404,000.00 for the period March 1, 1976 through February 28, 1979.[2] Bookstore receipts, again taken from petitioner's records, were $413,278.00. The remaining $990,722.00 was revenue from coin operated peep shows and the theater.

Mr. Wexler stated that the average movie peep show collected approximately $25.00 per day and 50 such machines were in operation during the audit period. By simply multiplying the number of machines, times average receipts of $25.00, times the number of days in a sales tax quarter (the machines were in operation 24 hours per

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[2] Petitioner's sales tax returns for this period reported gross sales of $1,027,494.00.

day, 7 days per week), he estimated quarterly receipts. Quarterly receipts were aggregated to estimate total receipts for the audit period of $604,501.00. Receipts from the live peep shows and private peep shows were estimated in the same fashion. Mr. Wexler estimated that these booths collected only $10.00 per day primarily because they were operated fewer hours per day and fewer days per week. Petitioner operated 18 live peep show booths and 5 private peep show booths during the audit period. Total receipts from these booths were estimated at $87,353.00 and $24,568.00 respectively.

Theater revenue was estimated by subtracting receipts from the peep shows from total receipts. It amounted to $274,300.00.

According to Mr. Wexler's calculations, the film viewing machines accounted for approximately 59 percent of all revenue from sources other than the bookstore. The live peep shows accounted for approximately 9 percent of such revenue; the private peep shows accounted for approximately 3 percent of such revenue; and the remaining 29 percent of this revenue was produced by the theater.

Petitioner presented the testimony of Mr. Ralph Schwarz, an attorney representing MJM Enterprises, which operates a business similar to that operated by petitioner. In the course of a sales tax audit of MJM, Mr. Schwarz was informed by the Division that coin-operated machines are not subject to sales tax. He communicated this information to MJM's accountant, Norman Waxman, who wrote to the Division's Technical Services Bureau to confirm that information. By letter dated January 10,

1983, the Division advised Mr. Waxman that coin operated machines for viewing films were not subject to sales tax. Mr. Waxman again wrote to the Division asking whether the Division's opinion would also apply to coin operated machines for viewing of a live performance. By letter dated May 5, 1983, a Division employee advised as follows:

> "Pursuant to the findings of the court in *Bathrick Enterprises vs. Murphy* the receipts from coin operated amusement devices are not for the rental of tangible personal property nor an admission charge to a place of amusement. We find little different between a coin operated device which allows viewing of a live performance and those addressed in Bathrick. Both devices are permitted to operate and function by the insertion of a coin and neither grant the patron admittance to a place of amusement. Accordingly, it is our opinion that the receipts from these devices are not subject to the sales tax."

As the result of a sales tax audit, MJM Enterprises was assessed $580,000.00 including penalty and interest, premised upon the ground that MJM's receipts from all coin-operated machines were subject to sales tax. The tax assessed on such receipts was cancelled following a conciliation conference conducted by the former Tax Appeals Bureau.

Petitioner presented the testimony of Dr. Winick and Mr. Schwarz to support its contention that the sales tax assessment in dispute was conducted as part of a plan to rid the Times Square area of sexually oriented businesses.

Dr. Winick testified that a major goal of the redevelopment program in Times Square was to close down businesses specializing in sex. He stated that police, building and fire inspectors were employed by the Midtown Enforcement Project to harass such businesses and involve them in costly legal proceedings. Mr. Schwarz testified that the City routinely made illegal arrests and seizures of films and projectors in order to disrupt these businesses. Petitioner's representative cited a number of court cases which document petitioner's claim that sex oriented businesses in Times Square were victims of selective law enforcement during the audit period.[3]

The Division was unable to present any witness who was present in 1605 during the audit period. Two witnesses testified regarding their observations, made within several days of this administrative proceeding, of activities taking place in an establishment similar in nature to 1605 called Show World. One of those witnesses, Dr. Camille Hardy, was qualified as an expert in the field of dance. It was her opinion that the performances she observed were not works of art. The precise nature of the activities engaged in by performers in the 1605 theater is a matter of dispute between the parties. However, the testimony presented by the Division did not contradict the general description of the activities taking place in

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[3] *See, Show World Center, Inc. v. Walsh*, 438 F Supp 642; *Blackjack Distributors, Inc. v. Beame*, 433 F Supp 1297. In both of the cited cases, the courts found substantial evidence that City agencies were engaged in a course of conduct that threatened the plaintiff's First Amendment rights.

1605 as set forth in the Stipulation,[4] and the testimony of Dr. Winick.

On August 1, 1989, petitioner and the Division of Taxation entered into the following stipulation.

Stipulation

WHEREAS the parties agree that the following facts are true:

(a) That for the sales tax quarters in issue, the petitioner was a corporation engaged in business in New York State, offering to the public various forms of adult entertainment, and selling tangible personal property.

(b) That some sales made by the petitioner were not subject to a sales tax; some were; others are in dispute.

(c) That among those that were not, were receipts generated by patrons viewing films in "peep" show machines, regardless of whether the machine was or was not housed in a booth.

(d) That other forms of entertainment and tangible personal property offered by the petitioner to the public on the petitioner's premises included the following:

(i) *Store* – The vendor sells the following merchandise: publications; newspapers; books;

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[4] The parties stipulated that there was a theater area on the second floor of 1605 where feature length films and short films were exhibited and live performances were given.

films, video movies; adult sexual aids, devices and games.

(ii) *Live "Peep Shows"* – This is now more commonly known in the industry as "peep-a-live" shows or "live peep shows". It consists of several coin-operated machines, housed in private booths that surround a stage on which nude or partially nude females perform. A glass partition separates the patron from the performers. For each minute that the patron wishes to view the performer, he must deposit a token valued at $0.25 into a machine which raised a partition in front of the glass.

(iii) *Motion Pictures Films and Live Shows* – In a theater area on the second floor of the premises, nude female performers occasionally perform on stage. Also, feature length motion picture films and short films are exhibited in the same area. For an admission of $5, the patron can remain in the theater area for an unlimited period of time.

(iv) *Private Peep Shows* – Similar to (ii) above, this is now more commonly known in the industry as "one-on-ones", or "fantasy booths". It consists of a coin-operated machine housed in a private booth which operates a glass partition which separates the patron and the female performer who is dressed in abbreviated attire. The patron can view the performer through the glass partition for a limited time and at the same time speak with her over an intercom system. For each minute that the patron wishes to continue to either view or speak with the performer he must deposit a token which has a higher value than the token required for the live peep shows.

(e) That, as described, these forms of entertainment are common to the "adult entertainment" industry and as presented, are the same as those presented in other "adult entertainment establishments" in New York City and elsewhere – except that in some establishments they follow an "open-window policy" in the "peep-a-live" and the "one-on-ones", the patron is allowed to touch the female performer. 1605 Bookcenter did not permit "open windows" or any touching between the patron and the performer.

(f) That the use of the terms "performance", "performer", "dance", and "dancer" in this stipulation is not meant to constitute an agreement or disagreement that the live peep shows, live shows and/or private "peep shows" are musical or dramatic arts performances within the meaning and intent of Tax Law § 1105(f)(1).

(g) That, during the audit period, the petitioner also made sales from vending machines located on its premises.

(h) That, except for taxable receipts constituting "vending machine sales and other income" (audit workpaper 12), the petitioner's store was leased out during the period 6/1/76 – 11/30/77, and the petitioner had no other taxable receipts during those periods.[5]

(i) That, based upon the expiration of the applicable period of limitations, the Audit Division cancels

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[5] Audit workpaper 12 indicates that no sales were made in the category of "Vending machines and other income" for the period September 1, 1976 through September 30, 1977.

taxes, penalties and interest assessed for the period 3/1/76 - 5/31/76.

(j) That, based upon the recent holding in *Adamides v. Chu* (134 AD2d 776 [3d Dept 1987]), the Audit Division cancels taxes, penalties and interest assessed for the periods 3/1/79 - 8/31/79.

(k) The Division of Taxation does not object to the amended petition dated April 27, 1983, but denies each and every allegation contained therein. The petitioner does not object that it has not been served with an answer to this amended petition, and agrees that, except for those matters stipulated and agreed to herein, the issues raised in the amended petition are in dispute.

It is therefore STIPULATED AND AGREED by and between the undersigned attorneys of record for the petitioner and the Division of Taxation that the above facts shall become the facts of the above matter and shall not be disputed by either party at the formal hearing to be held in this matter.

Opinion

The Administrative Law Judge determined that the Division of Taxation (hereinafter the "Division") properly requested and examined petitioner's books and records, properly determined that such were inadequate, and was authorized to estimate petitioner's tax liability for bookstore sales (i.e., books, magazines, novelties, films, etc.) through a test period markup audit pursuant to section 1138 of the Tax Law.

The Administrative Law Judge determined that petitioner's receipts from the sale of certain of its publications were exempt from sales tax under section 1115(a)(5) of the Tax Law because they were receipts from the sale of periodicals. The Administrative Law Judge found that petitioner, through the testimony of its expert on adult entertainment, Dr. Winick, and in the absence of evidence by the Division to show what criteria it applied in arriving at its determination that no magazines sold by petitioner satisfied the definition of a periodical, met its burden of proof that 92 percent of the publications it sold qualified as periodicals and were exempt from tax. The Administrative Law Judge determined that imposition of this burden of proof on petitioner was not a denial of its due process rights.

The Administrative Law Judge determined that charges imposed by petitioner for the viewing of live peep shows and private peep shows were subject to tax. Critical to the Administrative Law Judge's determination was the conclusion that the individual booths in which a customer viewed these shows were "places of amusement" as used in section 1105(f)(1) of the Tax Law, and that the receipts from the charges to view such shows were subject to tax as admission charges to a "place of amusement."

The Administrative Law Judge determined that petitioner, through the uncontroverted testimony of Mr. Wexler, established the amount of its receipts from live peep shows as $87,353.00 and from private peep shows as $24,568.00.

The Administrative Law Judge determined that the admission charges to the theater located on the second floor were not subject to sales tax as receipts from admission to "any place of amusement" because the theater was a motion picture theater, the admission charges of which are exempt from tax pursuant to Tax Law § 1105(f)(1). The Administrative Law Judge rejected the Division's assertion that the live shows performed periodically throughout the day altered the status of the facility as a motion picture theater.

Finally, the Administrative Law Judge determined that petitioner was not the victim of selective enforcement and that the audit was not conducted to harass petitioner or in any other way to interfere with its right to conduct its business.

Petitioner, on exception, asserts: that the Administrative Law Judge erred in finding that receipts from live peep shows and private peep shows are subject to sales tax; that the Administrative Law Judge erred in finding that the audit was not harassment of petitioner; that the failure of the Administrative Law Judge to declare section 1105(f)(1) and 20 NYCRR 528.6(c)(1) unconstitutional was in error; that petitioner had adequate books and records; and that "leniency" in construing the Tax Law requires cancellation of the tax and penalty assessed against petitioner because an ordinary person would not have known nor reasonably expected that sales tax was due on the coin operated devices involved in this case.

On exception, the Division asserts: that Doctor Winick was qualified as an expert in "adult entertainment," not an expert in law or taxation and, thus, his

testimony in these areas, even though uncontroverted, was insufficient to establish that 92 percent of the magazines sold by petitioner were periodicals exempt from taxation; that the Administrative Law Judge erred in determining that petitioner's theater was a motion picture theater, the admissions to which were exempt from tax; that petitioner did not meet its burden of establishing the amount of its receipts from live peep shows and private peep shows because Mr. Wexler's calculations were estimates made without benefit of documentation and, thus, were unreliable.

We uphold the determination of the Administrative Law Judge in its entirety.

We deal first with the issue of whether the Division properly requested and examined petitioner's books and records and properly resorted to estimating petitioner's bookstore sales pursuant to Tax Law § 1138.

We find nothing in the record to require us to modify the determination of the Administrative Law Judge on this issue. The Division properly requested, by the appointment letter dated May 7, 1979,[6] and examined petitioner's books and records for the entire period of the assessment at issue. It is undisputed that petitioner did not produce records of individual sales from which its ledgers and journals could be verified. While Mr. Wexler testified that petitioner maintained cash register tapes for

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[6] Contrary to petitioner's assertion, a copy of the appointment letter was placed in evidence as part of the field audit report (Exhibit H).

a period of three years, no such tapes were produced on audit or at hearing.

Moreover, the fact that petitioner had available all of its purchase invoices for the audit period does not prevent the Division from conducting a test period mark-up audit to determine petitioner's taxable sales (*Matter of Licata v. Chu*, 64 NY2d 873, 487 NYS2d 552). Finally, we note that the narrative portion of the audit report indicates petitioner agreed to a test period (Division's Exhibit H).

We deal next with the issue of whether the receipts from the sale of certain publications by petitioner were exempt from sales tax because they were receipts from the sales of periodicals.

We find nothing in the record that requires us to modify in any way the determination of the Administrative Law Judge that petitioner proved that 92 percent of publications sold by petitioner qualified as periodicals and were exempt from tax. Dr. Winick was qualified as an expert in the field of adult entertainment. He personally inspected magazines and newspapers sold by petitioner during the audit period and determined that 92 percent of these publications satisfied the requirements of the Commissioner's regulation (20 NYCRR 528.6[c][1]). Dr. Winick's testimony was uncontroverted by the Division and obviously found credible by the Administrative Law Judge.

We also sustain that portion of the Administrative Law Judge's determination that imposition of a burden of proof upon petitioner to demonstrate that certain of the

publications it sold qualified as periodicals is not a denial of its due process rights.

The California statute at issue in *Speiser v. Randall* (357 US 513), relied upon by petitioner, explicitly sought to condition entitlement to tax exemption on the basis of the content of certain speech and placed the burden upon the claimant to prove eligibility for the exemption at both the administrative level and upon judicial review. The court found that a state may deny a tax exemption to persons who actually engage in certain forms of proscribed speech, but held that the state must bear the burden of proof to show that the tax claimant engaged in such proscribed speech before denying the tax exemption on that basis. We agree with the Administrative Law Judge that the situation in *Speiser* has no parallel here. The California statute explicitly sought to condition entitlement to a tax exemption on the basis of the content of certain speech. The New York statute is neutral as to content. Furthermore, New York's courts have rejected the argument that, in discriminating between different types of publications, section 1115(a)(5) of the Tax Law is an infringement on freedom of the press or a denial of equal protection (*Matter of Twin Coast Newspapers v. State Tax Commn.*, 101 AD2d 977, 477 NYS2d 718; *Matter of G & B Publ. Co. v. Department of Taxation and Fin.*, 57 AD2d 18, 392 NYS2d 938, *lv denied* 42 NY2d 807). In light of those decisions, it is concluded that requiring petitioner to shoulder the burden of establishing entitlement to the exemption for periodicals is not a denial of its due process rights.

We deal next with the issue of whether receipts from live peep shows and private peep shows were subject to sales tax.

The Administrative Law Judge determined that the individual booths in which live peep shows and private peep shows could be viewed were "places of amusement" and that the receipts from the charges to view such shows were subject to tax as "admission charges" to a "place of amusement."[7]

The Administrative Law Judge reasoned that the essence of the transaction was the collection of a charge to watch a live sex show in a private place, the booth, something essentially different from the coin-operated automatic phonographs (jukeboxes) and bowling games at issue in *Matter of Bathrick Enters. v. Murphy* (27 AD2d 215, 277 NYS2d 869, *affd* 23 NY2d 664, 295 NYS2d 489), relied on by petitioner, and that the coin receptacles and rising screens were merely the means of collecting the charge and controlling the viewing time.

The lynchpin of petitioner's position is that the charge for admission into the booth is collected by the

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[7] Tax Law § 1105(f)(1) imposes sales tax on "*[a]ny admission charge* where such admission charge is in excess of ten cents to or for the use of any *place of amusement* in the state" (emphasis added).

The term "place of amusement" is defined as "[a]ny place where any facilities *for entertainment, amusement,* or sports are provided" (Tax Law § 1101[d][10], emphasis added).

The term "admission charge" is defined as "[t]he amount paid for admission, including any service charge and any charge for *entertainment or amusement* or for the use of facilities therefor" (Tax Law § 1101[d][2], emphasis added).

deposit of a coin into a coin receptacle. This fact, asserts petitioner, makes the booth an amusement device which should be treated for tax purposes exactly the same as coin operated peep show machines, the receipts from which the Division has stipulate are not subject to tax. Petitioner asserts that if "a coin operated amusement device or booth that exhibits a film is not a place of amusement, then it conclusively follows that the very same booth that permits the viewing of a woman cannot be a "place of amusement" (Petitioner's brief, pp. 37-38). Petitioner continues stating that "[t]here is no way anyone can say that a booth in which a film is viewed is not a 'place of amusement' and a booth in which a live person is viewed, or is spoken to, is a 'place of amusement.' It simply doesn't make sense" (Petitioner's brief, p. 40).

We agree with the determination of the Administrative Law Judge that the booths from which these live and private peep shows can be viewed are "places of amusement" and that the receipts from the charges to view such shows were subject to tax as "admission charges." Our decision is based upon the physical description of these booths and the mechanics of their operation.

The facts are uncontroverted that the mechanics for observing a peep show movie, a live peep show and a private peep show were essentially the same.[8] The patron entered a place, the booth, with a door that closed behind the person.

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[8] The taxability of charges for viewing of peep show movies is not before us. The only question before us is the taxability of receipts from live peep shows and private peep shows.

After entering the booth, the patron placed coins in a slot which caused a screen or curtain to rise and enabled the patron to view a show of some sort, either live or on film. When coins were placed in the slot, a light went on outside the booth to indicate that the booth was in use. The booth provided the patron with privacy, screened out noise and light and ensured that each patron paid a separate price for viewing.

The length of the viewing time was controlled by the number of coins the patron placed in the slot. When the patron's time ran out, the screen or curtain came down, and the patron exited the booth.

In short, each booth was a physical place which could be entered to watch a show for amusement. As such, the booths were clearly distinguishable from the coin operated automatic phonographs (jukeboxes) and bowling games located in restaurants, taverns and similar places which the court in *Bathrick* determined were not "places of amusement" (*Matter of Bathrick Enters. v. Murphy, supra*).

The facts here are also quite different from those in *Outdoor Amusement Business Assn. v. State Tax Commn.* (84 AD2d 950, 447 NYS2d 69, *revd on dissenting mem. below* 57 NY2d 790, 455 NYS2d 586) relied upon by petitioner. There the tax was sought to be imposed on the gross receipts of certain games operated by the taxpayer.

In his dissenting opinion, relied upon by the Court of Appeals, Judge Hancock stated:

> "[w]hether the booths or other places where the games are played are 'places of amusement' within the meaning of the statute is to me beside

the point. *The receipt sought to be taxed is not an 'admission charge' for admission to or for the use of a place of amusement* (Tax Law, § 1105, subd. [f], par. [1]).

* * *

"The games in question here are those typically found at county fairs, on midways, or at firemen's field days (e.g., throwing a football through a hole in a board, tossing a basketball through a hoop, throwing a baseball at a stuffed doll, climbing a rope ladder to ring a bell, covering a red spot on a board with five discs, etc.) in which the customer pays a fee to participate in the hope of winning one of the wide selection of prizes displayed . . . *It cannot be said that the charge is for 'admission to' a place of amusement as would be the case with a fee for entering a sideshow, for example* . . . Nor . . . can the fee be characterized as a charge 'for the use of the facilities' . . . as would be the case with the charge for riding the Ferris wheel or roller coaster. *The fee is paid for entering the contest and for the chance of winning a prize. Without that chance, no one would pay to play. Because the charge is not for admission or for the use of the facilities, it is not taxable" (Outdoor Amusement Business Assn. v. State Tax Commn., supra*, 477 NYS2d 69, 71-72 [dissenting opinion Judge Hancock]).

Clearly, the fees here are not for entering a contest. If anything, they are, in fact, more akin to the fee for entering a sideshow, which Judge Hancock would have characterized as an admission charge to a place of amusement.

The facts here are also distinguishable from those in *Matter of Fairland Amusements v. State Tax Commn.* (66

NY2d 932, 487 NYS2d 879), relied upon by petitioner. There, the Court of Appeals agreed with the dissenters in the Appellate Division "that there is an ambiguity in the statutory scheme which must be construed most strongly in favor of the taxpayer and against the government" (*Matter of Fairland Amusements v. State Tax Commn., supra*).

In *Fairland*, the taxpayer provided portable amusement rides such as Ferris wheels and merry-go-rounds, at fund-raising activities sponsored by various organizations. The charge at issue was to use the rides. The dissenters in the Appellate Division stated that Tax Law § 1105(f)(1) prescribed a two-step procedure to determine liability for tax:

> "First, the moneys must be paid as an admission charge, either a fee paid for entrance to a place or for the use of the facilities. Second, the tax is imposed only on the admission charge to or for the use of any place of amusement. 'Place of amusement' may be interpreted as meaning only the physical space within which the amusement is provided or the amusement facility itself. Applying the rationale of *Matter of Wien v. Murphy*, 28 A.D.2d 222, 284 N.Y.S.2d 303, *lv. denied* 22 N.Y.2d 646, 295 N.Y.S.2d 1027, 242 N.E.2d 493 and *Bathrick Enterprises v. Murphy*, 27 A.D.2d 215, 277 N.Y.S.2d 869, *affd.* 23 N.Y.2d 664, 295 N.Y.S.2d 489, 242 N.E.2d 745, it appears that if plaintiff's rides were located in a building, an admission charge to enter the building would be taxable but an admission charge to use the rides, regardless of whether admission to the building was free, would not be taxable.
>
> "However, this portion of the statute is ambiguous since another interpretation may be

> placed on it under which an admission charge to use plaintiff's rides would be taxable. The term '[a]ny place where any facilit[y] for . . . amusement . . . [is] provided' (Tax Law § 1101[d][10]) may be interpreted to mean the ride itself or the location upon which the ride rests. Thus, by implication, a charge for the use of the facilities may be taxable.
>
> " . . . [a]ccordingly, the statute and the applicable definitions must be construed to apply a tax only on the admission charge to enter the location where the amusement facilities are found" (*Fairland Amusements v. State Tax Commn., supra*, 487 NYS2d 879, 880).

We perceive no such ambiguity here. Petitioner's patrons entered a physical place, the booth, and paid a fee which provided them with a private space from which to watch the peep show. In short, each patron paid an admission charge to a place of amusement.

We next address the issue of whether admission charges to the theater located on the second floor of 1605 were subject to sales tax. We agree with the determination of the Administrative Law Judge. The determinative fact is "not the event to which the patrons gained admission, but the place where it was held" (*Matter of United Artists Theatre Circuit v. State Tax Commn.*, 52 NY2d 1013, 438 NYS2d 295 [where the court invalidated the Tax Commission's construction of the statute that the exclusion ran only to moving pictures, as running counter to the indices of legislative intent]). There is no question that the theater at issue here was for the showing of motion pictures. In any case, we find nothing in the record to suggest, as the Division asserts, that the showing of films was merely

incidental to live performances which also took place there.

We deal next with the issue of whether the Administrative Law Judge properly relied upon the testimony of Mr. Wexler to establish the allocation of receipts between live and private peep shows, which are taxable, and movie peep shows, which the Division stipulates are not taxable.

We affirm the determination of the Administrative Law Judge. Clearly, Tax Law § 1132 places the burden on petitioner to prove which of its receipts is not subject to tax (*see, Matter of Sol Wahba v. New York State Tax Commn.*, 127 AD2d 943, 512 NYS2d 542; *Matter of On the Rox Liqs. v. State Tax Commn.*, 124 AD2d 402, 507 NYS2d 503, *lv denied* 69 NY2d 603, 512 NYS2d 1026). Here, the Administrative Law Judge obviously found the testimony of Mr. Wexler credible, i.e., that the testimony was competent and truthful (*cf., Matter of Airport Indus. Park*, Tax Appeals Tribunal, April 11, 1991, [where the Administrative Law Judge determined that the testimony of petitioner's witness reconstructing the taxpayer's transactions was insufficient to establish the relationship between those transactions and the asserted capital improvements]). The testimony was specific as to the details of petitioner's business operations and was based on his review of petitioner's books and records, his general familiarity with petitioner's accounting methods and procedures, and his conversations with persons employed by petitioner during the audit period (*cf., Matter of Dacs Trucking Corp.*, Tax Appeals Tribunal, March 21, 1991 [where we reversed the determination of the Administrative Law Judge based on the grounds that testimony of the taxpayer's witness was

only to the "general nature" of the taxpayer's business and was, thus, insufficient to establish that certain of its transactions were exempt from tax as capital improvements]).

With regard to the Division's assertion that in order to carry its burden of proof it was necessary that petitioner present source documents or other forms of documentation to corroborate his testimony, we note that during the period under audit the Division's position was that all peep shows were taxable. As a result, there was no need during the period at issue to prepare documents which segregated taxable from nontaxable receipts. It was not until 1983 when the Division issued its opinion that movie peep shows were not taxable, that segregation of the receipts from various types of shows became necessary. The effect of the Division's assertion is to require petitioner to create such records retroactively, a result with which we cannot agree.

We also agree with the Administrative Law Judge that "relevant and probative hearsay evidence is admissible in administrative proceedings; moreover it may . . . constitute substantial evidence to support the administrative agency's determination" (*Matter of Flanagan v. New York State Tax Commn.*, 154 AD2d 758, 546 NYS2d 205, 206).

We deal next with petitioner's assertion that the Administrative Law Judge erred in failing to find, and

conclude as a matter of law that § 1105(f)(1) and 20 NYCRR 528.6(c)(1) are unconstitutional.[9]

Petitioner challenges the constitutionality of Tax Law § 1115(a)(5) and 20 NYCRR 528.6(c) on the grounds that "[t]he first amendment bars the imposition of a sales tax on the magazines sold by '1605' " Petitioner asserts that use of the term "periodical – without any definition – in section 1115(a)(5) . . . is unconstitutionally vague, on its face and as applied" and makes the same general assertion with respect to the definition of periodical in the regulation (Petitioner's brief, pp. 69-70).

Petitioner, in its brief, indicates that it is raising these arguments to preserve them for judicial review. In so doing, petitioner recognizes that the jurisdiction of this Tribunal, as prescribed in its enabling legislation, does not encompass challenges to the constitutionality of legislative enactments (*see, Matter of Fourth Day Enter.*, Tax Appeals Tribunal, October 27, 1988).

While this Tribunal has explicit authority to rule on the validity of the Commissioner's regulations (Tax Law § 2006[7]), we find no merit to petitioner's assertions concerning the regulation. Petitioner's objections to the

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[9] Petitioner deals only with section 1105(f)(1) and the regulation in its exception. However, in its brief, at page 57, petitioner also challenges the constitutionality of Tax Law § 1132(c) which provides in pertinent part that "it shall be presumed that all amusement charges of any type mentioned in (§ 1105[f][1]) are subject to tax until the contrary is established, and the burden of proving that any . . . amusement charge . . . is not taxable . . . shall be on the person required to collect tax . . . " Petitioner challenges the constitutionality of Tax Law § 1115(a)(5) in his brief at page 66.

regulation are to the criteria in it, i.e., " 'general availability to the public,' 'continuity of title,' 'variety' of articles, 'different' authors, 'general literature,' 'some special industry,' or 'other fields of endeavor,' . . . deprives '1605', and all distributors of magazines, of any meaningful way to determine whether or not the publications they sell are lawfully subject to a sales tax" (Petitioner's brief, p. 70).

The fact of the matter here is that petitioner's own witness, Dr. Winick, employed these criteria to determine that 92 percent of the publications petitioner sold qualified as periodicals for purposes of the exemption in section 1115(a)(5); the Administrative Law Judge accepted this result in her determination as does this Tribunal in this decision.

We deal finally with petitioner's assertion that the audit was conducted in a discriminatory manner. We agree with the Administrative Law Judge that petitioner has not established that this audit was conducted for purposes of harassing petitioner or in any way interfering with its right to conduct its business and, therefore, there is no reason to address petitioner's legal argument concerning selective enforcement.

Accordingly, it is ORDERED, ADJUDGE and DECREED that:

1. The exceptions of the Division of Taxation and of petitioner 1605 Bookcenter, Inc. are denied;

2. The determination of the Administrative Law Judge is affirmed;

3. The petition of 1605 Bookcenter, Inc. is granted to the extent indicated in the Administrative Law Judge's conclusions of law "D," "F," "G," "H" and "J" but is otherwise denied; and

4. The Division of Taxation is directed to modify the Notice of Determination issued for the period March 1, 1976 through August 31, 1979 in accordance with paragraph "3" above but such notice is otherwise sustained.

DATED: Troy, New York

JUL 25 1991

/s/ John P. Dugan
John P. Dugan
President

/s/ Francis R. Koenig
Francis R. Koenig
Commissioner

/s/ Maria T. Jones
Maria T. Jones
Commissioner

Determination of the Administrative Law Judge

STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition of 1605 BOOKCENTER, INC. for Revision of a Determination or for Refund of Sales and Use Taxes under Articles 28 and 29 of the Tax Law for the Period March 1, 1976 through August 31, 1979.	DETERMINATION

Petitioner, 1605 Bookcenter, Inc., c/o C & F Merchandise Company, 303 West 42nd Street, New York, New York 10036, filed a petition for revision of a determination or for refund of sales and use taxes under Articles 28 and 29 of the Tax Law for the period March 1, 1976 through August 31, 1979 (File No. 800121).

A hearing was commenced before Jean Corigliano, Administrative Law Judge, at the offices of the Division of Tax Appeals, Two World Trade Center, New York, New York, on August 1, 1989 at 9:15 A.M. and continued to conclusion on August 2, 1989 at 9:15 A.M., with all briefs to be submitted by March 14, 1990. Petitioner appeared by Herald Price Fahringer, Esq. The Division of Taxation appeared by William F. Collins, Esq. (Michael B. Infantino, Esq., of counsel).

ISSUES

I. Whether petitioner maintained and made available to the Division of Taxation adequate and complete books and records from which the exact amount of tax due have been determined.

II. Whether, if adequate books and records were not maintained, the test period markup audit of petitioner's bookstore sales was reasonable.

III. Whether petitioner's receipts from the sale of certain publications were exempt from sales tax under section 1115(a)(5) of the Tax Law because they were receipts from the sale of periodicals.

VI. Whether charges imposed by petitioner for the viewing of live performances through a coin-operated apparatus were subject to sales tax.

V. Whether charges imposed by petitioner for admission to a theatre where motion pictures and live performances were shown were subject to sales tax.

VI. Whether the sales tax audit was conducted in a discriminatory manner or for the purpose of curtailing petitioner's First Amendment rights.

FINDINGS OF FACT

1. On July 21, 1980, the Division of Taxation issued to petitioner, 1605 Book Center, Inc., a Notice of Determination and Demand for Payment of Sales and Use Taxes Due for the period March 1, 1976 through August 31, 1979, assessing tax due of $141,686.11 plus interest.

No tax was assessed for the period September 1, 1976 through August 31, 1977.

2. Petitioner operated a commercial establishment in New York City's Times Square area. It was in the business of selling books, magazines, newspapers and novelty items, operating a theater where movies were exhibited and live performances were given, and providing "peep" shows. Its entire business was sexually oriented and all materials and performances offered to its patrons were sexually explicit.

3. An audit of 1605 began in or around May 1979. By letter dated May 7, 1979, the Division informed petitioner that a field examination of petitioner's books and records for the period March 1, 1976 through February 28, 1979 had been scheduled for May 14, 1979. The letter stated: "All books and records pertaining to your Sales Tax liability for the period under audit should be available. This would include journals, ledgers, sales invoices, purchase invoices, cash register tapes, exemption certificates, etc. and all Sales Tax records." The following books and records were made available by petitioner: sales tax returns and related worksheets, Federal income tax returns and related worksheets, a sales journal, a purchases journal, some purchase invoices, and a general ledger. These records were judged to be in good condition.

4. Petitioner's general ledge showed gross receipts broken down into three categories: taxable [bookstore], nontaxable [bookstore] and vending machines. The auditor was informed that petitioner considered one-third of its bookstores sales to be taxable. All other receipts from

all other sources were deemed by petitioner to be nontaxable. None of the auditors who participated in this audit were available to testify, and it is not possible to determine from the audit documents the exact nature of the charges included in each of the three categories shown in the general ledger. The Field Audit Report indicates that four categories of sales were included by the Division under the general heading "vending machines and other income": (1) sales income from live burlesques shows; (2) sales income from live peep shows; (3) sales income from vending machines; and (4) sales income from film viewers. All of these receipts were determined by the Division to be subject to sales tax. Total vending machine and other receipts as shown in petitioner's general ledger were $1,577,592.32, with a tax due on that amount of $126,207.39.

5. The Division performed a test period markup audit of petitioner's bookstore sales. The narrative portion of the field audit report provided only a minimal description of the audit methodology employed; however, the audit workpapers were detailed and did demonstrate the method used.

(a) The test period selected was June 1978. Petitioner supplied invoices from two suppliers: Model Distributors and Century Sales Company.

(b) The auditor listed each invoice on a columnar sheet by date, invoice number and the total amount of each invoice. A fourth column was headed "taxable purchases". Publications with the following titles were deemed to be nontaxable purchases: Advocate, Screw,

Pleasure, Hook, Unique, Swing, Black and several publications identified only by initials. All other publications were deemed taxable, including publications identified on the invoices only as magazines, comics or by order number or title. Those publications deemed nontaxable were not included in the markup test figures. Century invoices showed only two items, dolls and unspecified magazines; the former were films purchased for use in the film viewing booths and for sale in the bookstore.

(c) The Model invoices generally showed a "cover price", quantity, unit purchase price, and total purchase price for each item listed. The auditor applied the cover price to the number of items purchased to calculate total taxable sales of each item. Taxable sales of each item were totaled on each invoice and entered on the auditor's worksheet as "taxable at selling". This category will be referred to here as audited taxable sales. Where a cover price was not shown, the auditor marked up purchases on the Model invoices by 50 percent to determine the selling price. This percentage was obtained from an individual identified in the record only by name. Total purchases shown on the Century invoices were marked up 100 percent to determine a selling price. The basis for this markup percentage is not in the record.

(d) Both Model and Century issued credit invoices for returned items. Amounts on the credit invoices were subtracted from total purchases and taxable purchases. For the purpose of determining audited taxable sales on returned items, total credit given was marked up 66 percent on Model invoices and 100 percent on Century invoices. Using this method the auditor determined that

total purchases from Model were $6,952.42; taxable purchases were $4,847.34 and audited taxable sales were $7,916.60. From the Century invoices, total purchases were $5,009.95 (including a shipping and handling charge of $6.20), taxable purchases were $5,002.75, and audited taxable sales were $10,007.50. The auditor determined that petitioner purchased some films for use in its 46 film viewing machines, rather than for resale, and an adjustment was made to reflect this fact. After this adjustment was made, total purchases were determined to be $11,962.37, taxable purchases were determined to be $8,471.05, and audited taxable sales were determined to be $15,164.10. Taxable purchases were divided by total purchases to calculate a taxable ration of 70.81 percent. The auditor also calculated a markup of 79.01 by subtracting taxable purchases from audited taxable sales and dividing the result by audited taxable sales.

(e) Additional taxable bookstore sales were determined by applying the taxable ratio to total purchases as shown in petitioner's records to determine audited taxable purchases. The markup percentage of 79.01 was applied to audited taxable purchases to calculate audited taxable sales of $406,487.00. An error rate of .9084 was determined from a mathematical comparison of reported taxable sales to audited taxable sales. Application of the error rate to reported taxable sales yielded additional taxable sales of $193,484.00 with a tax due on that amount of $15,478.72. No tax was assessed for the period June 1, 1976 through November 30, 1977.

6. As an adjunct, or more likely a preliminary, to the markup test, the auditor prepared a schedule, segregating purchases shown on the June 1978 invoices into four

categories: papers, pocket books, magazines and novelties. The publications placed in the category of "papers" were the same as those determined to be nontaxable in the markup test. Publications identified only as magazines or comics were placed in the category magazines. Publications clearly identified as books, those having a cover price of less than three dollars and those identified only by order number were classified as pocket books. All other publications were classified as magazines. In the markup test audit, all magazines were deemed taxable.

7. When conducting a test period audit of a bookstore selling sexually explicit materials, the Division currently instructs auditors to examine each publication on sale during the test period, to record the title of the publication and some information about the contents, and to indicate whether the publication is issued periodically. There is no evidence in the record that this procedure was followed here.

8. On August 1, 1989, petitioner and the Division of Taxation entered into a stipulation which is adopted here as Finding of Fact "9". It is supplemented by additional facts as indicated.

Stipulation

9. WHEREAS the parties agree that the following facts are true:

(a) That for the sales tax quarters in issue, the petitioner was a corporation engaged in business in New

York State, offering to the public various forms of adult entertainment, and selling tangible personal property.

(b) That some sales made by the petitioner were not subject to a sales tax; some were; others are in dispute.

(c) That among those that were not, were receipts generated by patrons viewing films in "peep" show machines, regardless of whether the machine was or was not housed in a booth.

(d) That other forms of entertainment and tangible personal property offered by the petitioner to the public on the petitioner's premises included the following:

(i) *Store* – The vendor sells the following merchandise: publications; newspapers; books; films; video movies; adult sexual aids, devices and games.

(ii) *Live "peep" shows* – This is now more commonly known in the industry as "peep-a-live" shows or "live peep shows". It consists of several coin-operated machines, housed in private booths that surround a stage on which nude or partially nude females perform. A glass partition separates the patron from the performers. For each minute that the patron wishes to view the performer, he must deposit a token valued at $0.25 into a machine which raised a partition in front of the glass.

(iii) *Motion Pictures Films and Live Shows* – In a theater area on the second floor of the premises, nude female performers occasionally perform on stage. Also, feature length motion picture films and short films are exhibited in the same area. For an admission of $5, the patron can remain in the theater area for an unlimited period of time.

(iv) *Private Peep Shows* – Similar to (ii) above, this is now more commonly known in the industry as "one-on-ones", or "fantasy booths". It consists of a coin-operated

machine housed in a private booth which operates a glass partition which separates the patron and the female performer who is dressed in abbreviated attire. The patron can view the performer through the glass partition for a limited time and at the same time speak with her over an intercom system. For each minute that the patron wishes to continue to either view or speak with the performer he must deposit a token which has a higher value than the token required for the live peep shows.

(e) That, as described, these forms of entertainment are common to the "adult entertainment" industry and as presented, are the same as those presented in other "adult entertainment establishments" in New York City and elsewhere – except that in some establishments they follow an "open-window policy" in the "peep-a-live" and the "one-on-ones", the patron is allowed to touch the female performer. 1605 Bookcenter did not permit "open windows" or any touching between the patron and the performer.

(f) That the use of the terms "peformance", "performer", "dance", and "dancer" in this stipulation is not meant to constitute an agreement or disagreement that the live peep shows, live shows and/or private "peep shows" are musical or dramatic arts performances within the meaning and intent of Tax Law § 1105(f)(1).

(g) That, during the audit period, the petitioner also made sales from vending machines located on its premises.

(h) That, except for taxable receipts constituting "vending machines sales and other income" (audit workpaper 12), the petitioner's store was leased out during the

period 6/1/76 - 11/30/77, and the petitioner had no other taxable receipts during those periods.[1]

(i) That, based upon the expiration of the applicable period of limitations, the Audit Division cancels taxes, penalties and interest assessed for the period 3/1/76 - 5/31/76.

(j) That, based upon the recent holding in *Adamides v. Chu* (134 AD2d 776 [3d Dept 1987]), the Audit Division cancels taxes, penalties and interest assessed for the periods 3/1/79 - 8/31/79.

(k) The Division of Taxation does not object to the amended petition dated April 27, 1983, but denies each and every allegation contained therein. The petitioner does not object that it has not been served with an answer to this amended petition, and agrees that, except for those matters stipulated and agreed to herein, the issues raised in the amended petition are in dispute.

It is therefore STIPULATED AND AGREED by and between the undersigned attorneys of record for the petitioner and the Division of Taxation that the above facts shall become the facts of the above matter and shall not be disputed by either party at the formal hearing to be held in this matter.

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[1] Audit workpaper 12 indicates that no sales were made in the category of "Vending machines and other income" for the period September 1, 1976 through September 30, 1977.

Additional Findings of Fact

10. Petitioner's business is no longer in operation. The only witness who was on the premises of 1605 during the audit period was Dr. Charles Winick, who was qualified as an expert in the field of so-called "adult entertainment". Dr. Winick visited 1605 in 1978 and 1979. He testified that the mechanics for observing a peep show movie, a live peep show and a private show were essentially the same. The patron entered a booth with a door that could be closed behind him. He placed coins in a slot which caused a screen or curtain to rise and enabled him to view a show of some sort, either live or on film. The booth provided the patron with privacy, screened out noise and light and ensured that each patron paid a separate charge for viewing. When coins or tokens were placed in the slot, a light went on outside the booth to indicate that booth was in use. The length of the patron's viewing time was controlled by the number of tokens he placed in the slot. When his time ran out, the screen or curtain came down, and the patron exited the booth.

11. Dr. Winnick [sic] personally observed a theater located on the second floor of 1605. The theater was described as being approximately 15 feet by 20 feet and large enough to hold about 50 patrons. The movies shown at that time were generally feature length pornographic films such as "Deep Throat" and "Behind the Green Door". The films were shown continuously from approximately noon until 11:00 P.M., interspersed by live performances of approximately 15 to 20 minutes in length.

12. At the request of petitioner's counsel, Dr. Winick conducted a survey in 1978 of publications sold

by petitioner. He examined every publication in a magazine format, identifying its contents, format, publisher, date of publication, and evidence of serial publication such as a volume number, issue number and year. He inspected 351 publications and found only 29 that lacked evidence of serial publication. The publications he examined typically contained pieces of fiction and separate articles on a variety of topics.

13. Petitioner offered the testimony of Scott Wexler, the comptroller since 1985 of C & F Merchandising, a holding company for 1605 and other affiliated companies, to describe the accounting methods and procedures in effect during the audit period. Mr. Wexler's testimony was based on his familiarity with petitioner's accounting system and procedures and conversations with persons employed by petitioner during the audit period. He stated that receipts from peep shows were not segregated according to the type of entertainment being provided because all peep show receipts were considered to be nontaxable. The peep show apparatus included a meter which registered the number of coins placed in the receptacle. Approximately twice a week, an employee opened the coin receptacles, collected the monies inside, read the meters and entered the meter reading for each individual apparatus on a columnar sheet. The meter readings were used as an internal control. After the monies collected were verified against the meter readings, the sheets were discarded. According to Mr. Wexler, the category in the general ledger entitled "vending machines" included receipts from the peep shows and from the theater.

Mr. Wexler testified that the bookstore used a cash register which produced a tape. The tapes were kept for

at least three years. No tapes were produced at hearing. According to Mr. Wexler, petitioner and its affiliated companies regularly perform their own tests to determine what portion of their bookstore sales are subject to sales tax. Petitioner estimated that one-third of its bookstore sales were taxable based on such a test.

14. Mr. Wexler performed his own calculations to estimate gross receipts from the different types of peep shows.

(a) Total revenue from all operations, taken from petitioner's books and records, was stated to be $1,404,000.00 for the period March 1, 1976 through February 28, 1979.[2] Bookstore receipts, again taken from petitioner's records, were $413,278.00. The remaining $990,722.00 was revenue from coin operated peep shows and the theater.

(b) Mr. Wexler stated that the average movie peep show collected approximately $25.00 per day and 50 such machines were in operation during the audit period. By simply multiplying the number of machines, times average receipts of $25.00, times the number of days in a sales tax quarter (the machines were in operation 24 hours per day, 7 days per week), he estimated quarterly receipts. Quarterly receipts were aggregated to estimate total receipts for the audit period of $604,501.00. Receipts from the live peep shows and private peep shows were estimated in the same fashion. Mr. Wexler estimated that these booths collected only $10.00 per day primarily

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[2] Petitioner's sales tax returns for this period reported gross sales of $1,027,494.00.

because they were operated fewer hours per day and fewer days per week. Petitioner operated 18 live peep show booths and 5 private peep show booths during the audit period. Total receipts from these booths were estimated at $87,353.00 and $24,568.00 respectively.

(c) Theater revenue was estimated by subtracting receipts from the peep shows from total receipts. It amounted to $274,300.00.

(d) According to Mr. Wexler's calculations, the film viewing machines accounted for approximately 59 percent of all revenue from sources other than the bookstore. The live peep shows accounted for approximately 9 percent of such revenue; the private peep shows accounted for approximately 3 percent of such revenue; and the remaining 29 percent of this revenue was produced by the theater.

15. Petitioner presented the testimony of Mr. Ralph Schwarz, an attorney representing MJM Enterprises, which operates a business similar to that operated by petitioner. In the course of a sales tax audit of MJM, Mr. Schwarz was informed by the Division that coin-operated machines are not subject to sales tax. He communicated this information to MJM's accountant, Norman Waxman, who wrote to the Division's Technical Services Bureau to confirm that information. By letter dated January 10, 1983, the Division advised Mr. Waxman that coin operated machines for viewing films were not subject to sales tax. Mr. Waxman again wrote to the Division asking whether the Division's opinion would also apply to coin operated machines for viewing of a live performance. By

letter dated May 5, 1983, a Division employee advised as follows:

> "Pursuant to the findings of the court in *Bathrick Enterprises vs. Murphy* the receipts from coin operated amusement devices are not for the rental of tangible personal property nor an admission charge to a place of amusement. We find little difference between a coin operated device which allows viewing of a live performance and those addressed in Bathrick. Both devices are permitted to operated and function by the insertion of a coin and neither grant the patron admittance to a place of amusement. Accordingly, it is our opinion that the receipts from these devices are not subject to the sales tax."

16. As the result of a sales tax audit, MJM Enterprises was assessed $580,000.00, including penalty and interest, premised upon the ground that MJM's receipts from all coin-operated machines were subject to a sales tax. The tax assessed on such receipts was cancelled following a conciliation conference conducted by the former Tax Appeals Bureau.

17. Petitioner presented the testimony of Dr. Winick and Mr. Schwarz to support its contention that the sales tax assessment in dispute was conducted as part of a plan to rid the Times Square area of sexually oriented businesses. Dr. Winick testified that a major goal of the redevelopment program in Times Square was to close down businesses specializing in sex. He stated that police, building and fire inspectors were employed by the Midtown Enforcement Project to harass such businesses and involve them in costly legal proceedings. Mr.

Schwarz testified that the City routinely made illegal arrests and seizures of films and projectors in order to disrupt these businesses. Petitioner's representative cited a number of court cases which document petitioner's claim that sex oriented businesses in Times Square were victims of selective law enforcement during the audit period.[3]

18. The Division was unable to present any witness who was present in 1605 during the audit period. Two witnesses testified regarding their observations, made within several days of this administrative proceeding, of activities taking place in an establishment similar in nature to 1605 called Show World. One of those witnesses, Dr. Camille Hardy, was qualified as an expert in the field of dance. It was her opinion that the performances she observed were not works of art. The precise nature of the activities engaged in by performers in the 1605 theater is a matter of dispute between the parties. However, the testimony presented by the Division did not contradict the general description of the activities taking place in 1605 as set forth in the Stipulation,[4] and the testimony of Dr. Winick.

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[3] *See, Show World Center, Inc. v. Walsh,* 438 F Supp. 642, *Blackjack Distributors, Inc. v. Beame,* 433 F Supp. 1297. In both of the cited cases, the courts found substantial evidence that City agencies were engaged in a course of conduct that threatened the plaintiff's First Amendment rights.

[4] The parties stipulated that there was a theater area on the second floor of 1605 where feature length films and short films were exhibited and live performances were given.

SUMMARY OF THE PARTIES' POSITIONS

19. Petitioner takes the following positions with regard to each of the individual issues in dispute:

(a) Petitioner argues that its books and records were adequate for the purpose of verifying its reported taxable sales, hence resort to a test period markup audit was not authorized by the Tax Law.

(b) Petitioner contends that the testimony of Dr. Winick was adequate to prove that 92 percent of the publications sold by 1605 qualified as periodicals under the regulations set forth by the Commissioner of Taxation and Finance. Alternatively, it argues that section 1115(a)(5) of the Tax Law, exempting newspapers and periodicals from sales tax, is unconstitutionally vague and overbroad, and that 20 NYCRR 528.6[c], defining the term "periodical", is unconstitutional on its face and as applied here. Petitioner also argues that placing the burden of proof upon petitioner to establish that it qualifies for the tax exemption for newspapers and periodicals is a violation of petitioner's rights under the Federal and State constitutions.

(c) Petitioner argues that the live peep shows and private peep shows are not "places of amusement" as that term has been defined by New York's courts and hence receipts from the peep shows are not subject to sales tax.

(d) Petitioner states that the theater located in 1605 was a movie theater and as such was exempt from sales tax under section 1105(f)(1) of the Tax Law, even though the film showings were interspersed by live performances. Although petitioner initially argued at hearing

that the performances were exempt from sales tax as "dramatic or musical arts performances", it apparently abandoned this position and made no arguments in this regard in its brief.

(e) Finally, petitioner maintains it is the victim of selective enforcement of the sales tax law which in itself is a ground for cancellation of the tax assessment.

20. The Division takes the following position with regard to the items in dispute:

(a) The Division contends that petitioner's records were inadequate and insufficient to verify reported taxable sales thus justifying resort to a test period audit to determine petitioner's tax liability.

(b) The Division maintains that each booth housing a live peep show and private peep show was a separate "place of amusement", hence the charges collected by the coin-operated machines were charges for admission to a place of amusement, taxable under section 1105(f)(1) of the Tax Law.

(c) The Division maintains that Dr. Winick's testimony did not establish by clear and convincing evidence the nontaxability of any of petitioner's receipts from the sale of publications. The Division disputes petitioner's contentions that it is a violation of petitioner's constitutional rights to place the burden of proof on petitioner to show that its receipts from the sale of printed material were not subject to tax.

(d) Based on the testimony of Dr. Hardy, the Division claims that it carried its burden of proof to show that charges for admission to the theater operated by 1605

were not charges for admission to a dramatic or musical arts performance. The Division further argues that the live performances provided in the 1605 theater were the featured attractions and that the movies were merely "fillers". On this ground, the Division maintains that charges for admission to the theater were not excluded from tax as admissions to a movie theater.

CONCLUSIONS OF LAW

A. Every person required to collect tax must maintain records sufficient to verify all transactions, in a manner suitable to determine the correct amount of tax due (Tax Law § 1135[a]; 20 NYCRR 533.2[a]). These records must be made available for the Division's inspection upon request (20 NYCRR 533.2[a][2]). Among the records required to be maintained are "records of every sale or amusement charge" and the tax due on that sale or charge (Tax Law § 1135[a]).

When conducting an audit, the Division of Taxation may not simply ignore a taxpayer's records if those records provide an adequate basis on which to determine the amount of tax due (*Matter of Chartair, Inc. v. State Tax Commn.*, 65 AD2d 44, 411 NYS2d 41); however, the Division is not required to rely upon a taxpayer's non-source documentation and determine the amount of tax due based upon documents which cannot be verified (*Matter of Meyer v. State Tax Commn.*, 61 AD2d 223, 402 NYS2d 74, *lv denied* 44 NY2d 645; *see also, Matter of Ronnie's Suburban Inn*, Tax Appeals Tribunal, May 11, 1989).

To determine the adequacy of a taxpayer's records, the Division must first request and thoroughly examine

the taxpayer's books and records for the entire period of the proposed assessment (*Matter of Adamides v. Chu*, 134 AD2d 776, 521 NY2d 826, *lv denied* 71 NY2d 806); *Matter of King Crab v. State Tax Commn.*, 134 AD2d 51, 522 NYS2d 978). The purpose of this examination is to determine whether the records are so insufficient as to make it virtually impossible for the Division to verify taxable sales receipts and conduct a complete audit (*Matter of Chartair, Inc. v. State Tax Commn., supra; Matter of Ronnie's Suburban Inn, supra*). In the absence of adequate books and records, the Division is authorized to determine the amount of tax due on the basis of the information available and may resort to external indices if necessary (Tax Law § 1138[a][1]; *Matter of Carmien Restaurant v. State Tax Commn.*, 99 AD2d 581, 471 NYS2d 402).

B. Petitioner's first contention is that its books and records were adequate for the purpose of verifying its taxable sales; therefore, the Division lacked the statutory authority to conduct a test period audit of petitioner's business operations. This contention does not stand up to scrutiny. First, the appointment letter dated May 7, 1979 is sufficient evidence that the Division requested all of petitioner's books and records for the period March 1, 1976 through February 28, 1979, including cash register tapes and sales invoices (*see, Matter of Great Neck Service Station*, Tax Appeals Tribunal, May 26, 1988). While petitioner made available to the Division all of its ledgers and journals, or books of original entry, it is undisputed that petitioner did not maintain records of individual sales from which its ledgers and journals could be verified. Mr. Wexler testified that the peep show apparatus included a meter which petitioner used to maintain internal controls.

These meter readings would have provided a means of verifying the figures recorded in petitioner's books, but they were destroyed after several months. Cash register tapes were maintained for a period of three years, but they would not have provided the auditor with a basis for determining whether tax had been charged on all taxable items; therefore, even if made available, the tapes would have been useless for audit purposes (*see, Matter of Licata v. Chu*, 64 NY2d 873; 487 NYS2d 552).

To a great extent, the audit here, and the tax determined to be due, was premised upon petitioner's own books and records. The total amount of petitioner's gross receipts from all sources was taken by the Division from petitioner's general ledger. The test period audit was used only to determine whether petitioner accurately reported taxable sales of tangible personal property sold in its bookstore. Petitioner admitted, to the auditor and at hearing, that it estimated its taxable sales through its own testing procedures. Since petitioner did not maintain a verifiable record of individual sales, the Division was warranted in conducting its own test period audit to determine the accuracy of petitioner's records.

C. Petitioner challenges the imposition of sales tax in three areas: the tax on publications sold in its bookstore; the tax on receipts collected through coin-operated machines; and the tax on admission charges to the theater. Each of these raise different issues of law and fact.

D. Tax Law § 1105(a) imposes a sales tax on receipts from every retail sale of tangible personal property. Tax Law § 1115(a)(5) exempts from tax the receipts from the sale of "newspapers and periodicals". The statute does

not provide a definition of either. On January 31, 1979, the former State Tax Commission promulgated a regulation defining the term "periodical", effective January 31, 1979. 20 NYCRR 528.6(c)(1) provides:

> "(1) In order to constitute a periodical, a publication must conform generally to the following requirements:
>
> (i) it must be published in printed or written form at stated intervals, at least as frequently as four times a year;
>
> (ii) it must not, either singly or, when successive issues are put together, constitute a book;
>
> (iii) it must be available for circulation to the public;
>
> (iv) it must have continuity as to title and general nature of content from issue to issue; and
>
> (v) each issue must contain a variety of articles by different authors devoted to literature, the sciences or the arts, news, some special industry, profession, sport or other field of endeavor."

Tax Law § 1132(c) creates a presumption that all receipts for the sale of tangible personal property are subject to sales tax and places the burden of proving otherwise on the taxpayer. As a general rule, statutory exemptions from tax are strictly construed against the party claiming the exemption and the claimant must clearly establish his right to the exemption (*Grace v. New York State Tax Commn.*, 37 NY2d 193, 196, 371 NYS2d 715).

Citing *Speiser v. Randall* (357 US 513), petitioner argues that, because its free speech rights are implicated, it is unlawful to place the burden of proof on petitioner to show entitlement to the statutory exemption for periodicals. It is no secret that allocation of the burden of proof is often determinative of the outcome of an issue. For that reason, it is necessary to treat this argument first. In *Speiser,* war veterans claiming a property tax exemption provided for in the California Constitution were required to sign a loyalty oath which, among other things, stated that they did not advocate violent overthrow of the government. Those who refused to sign the oath were denied the tax exemption, but signing the oath did not insure entitlement to the exemption since the tax assessor was still free to investigate facts and deny the exemption. In either case, California law placed the burden upon the claimant to prove eligibility on the administrative level and upon judicial review. The Court found that a State may deny a tax exemption to persons who actually engage in certain forms of proscribed speech, but held that the State must bear the burden of proof to show that the tax claimant engaged in criminal speech before denying the tax exemption on that basis (*Speiser v. Randall, supra*). The situation in *Speiser* has no parallel here. The California statute explicitly sought to condition entitlement to a tax exemption on the basis of the content of certain speech. The New York statute is neutral as to content. Furthermore, New York's courts have rejected the argument that, in discriminating between different types of publications, section 1115(a)(5) of the Tax Law is an infringement on freedom of the press or a denial of equal protection (*Matter of Twin Coast Newspapers v. State*

Tax Commn., 101 AD2d 977, 477 NYS2d 718; *Matter of G & B Publishing Co. v. Department of Taxation and Finance*, 57 AD2d 18, 392 NYS2d 938, *lv denied* 42 NY2d 807). In light of those decisions, it is concluded that requiring petitioner to shoulder the burden of establishing entitlement to the exemption for periodicals is not a denial of its due process rights.

Petitioner's position is that it met its burden through the testimony of Dr. Winick. Dr. Winick was qualified as an expert in the field of "adult entertainment". He studies the sex industry. He personally inspected magazines and newspapers sold by petitioner during the audit period and determined that 92 percent of those publications satisfied the requirements set forth in 20 NYCRR 528.6(c)(1).[5] Dr. Winick's testimony was uncontroverted by either witnesses or documentation. The audit report does not disclose the criteria employed by the Division in determining whether publications sold by petitioner were periodicals as the term is used in the Tax Law. The Division's representative assumed, as part of his legal

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[5] Petitioner notes that 20 NYCRR 528.6 was not promulgated until the very end of the audit period, and it argues that in determining whether its publications satisfied the statute the common law definition of a periodical should apply. In *G & B Publishing Co. (supra)* the court held that in the absence of a regulatory definition of a periodical, it is appropriate to resort to a "test of common understanding influenced by authority from collateral soruces". It is not apparent that the regulation departs from this general understanding, and petitioner has not offered an alternative definition of the term. Accordingly, it is found that the regulation does not significantly depart from the common law definition (*see, Matter of Blackjack Distributors*, State TAx Commission, May 6, 1983 [TSB-H-83(131)S]).

argument, that the auditor reviewed the various publications and applied the criteria found in the regulation. But there is no evidence in the record to prove whether this was done. Moreover, no one employed by the Division during the audit period testified as to the general procedure followed by the Division during the time of the audit. The audit workpapers suggest that the auditor worked directly from the purchase invoices. All items classified on the invoices as magazines were categorized as taxable purchases while all newspapers were classified as nontaxable purchases. It is interesting to note that the term periodical was not used by the auditor. While the Division is not responsible for demonstrating the propriety of its assessment (*Matter of Blodnick v. State Tax Commn.*, 124 AD2d 437), there must still be facts in the record from which an independent decisionmaker can determine whether a rational basis existed for the auditor's calculations (*Matter of Grecian Square v. State Tax Commn.*, 119 AD2d 948, 501 NYS2d 219; *Matter of Estate of Alice M. Fashana*, Tax Appeals Tribunal, September 21, 1989). In this case, there is no evidence in the record to show what criteria was applied in arriving at the determination that no magazines sold by petitioner satisfied the definition of a periodical. Inasmuch as there is no evidence in the record to the contrary, Dr. Winick's testimony is sufficient to establish that 92 percent of the magazines sold by petitioner were periodicals. The Division is directed to recompute the taxable ratio which resulted from the test period audit test and petitioner's tax liability, accordingly.

E. The next issue is whether receipts from the coin-operated peep show machines were subject to sales tax.

Tax Law § 1105(f)(1) provides, in pertinent part, that a sales tax should apply to "[a]ny admission charge where such admission charge is in excess of ten cents to or for the use of any place of amusement in the state". The term "place of amusement" is defined by Tax Law § 1101(d)(10) as "[a]ny place where any facilities for entertainment, amusement, or sports are provided", and the term "admission charge" is defined by Tax Law § 1101(d)(1) as "[t]he amount paid for admission, including any service charge and any charge for entertainment or amusement or for the use of facilities therefor".

The issue before the Appellate Division, Third Department in *Matter of Fairland Amusement v. State Tax Commn.* (110 AD2d 952, 487 NYS2d 879) was whether the sales tax imposed by Tax Law § 1105(f)(1) applies to amusement ride tickets for individual carnival rides. Affirming the determination of the State Tax Commission, the court held that the sales tax applied, since the charge was "for entertainment or amusement or for the use of facilities therefor" (Tax Law § 1101[d][2]). The Court of Appeals reversed, adopting the logic of the dissenting opinion below (*Matter of Fairland Amusement v. State Tax Commn.*, 66 NY2d 932, 498 NYS2d 796). The Court found that there is an ambiguity in the taxing statute. When the provision imposing the tax is read in conjunction with the applicable definitions, "place of amusement" may be interpreted as meaning only the physical space within which entertainment or amusement facilities are provided or the amusement facility itself. Citing the general principle that any ambiguity in the statutory scheme must be construed most strongly in favor of the taxpayer, the court found that the sales tax does not apply to charges for the use of amusement facilities, but only to "an admission

charge to enter the location where amusement facilities are found" (*Matter of Fairland v. State Tax Commn., supra,* 487 NYS2d 879, 880, J. Mikoll, dissenting). The question before us then distills to whether a peep show is "[a] place where any facilities for entertainment [or] amusement . . . are provided" (Tax Law § 1101[d][10]).

The Division concedes that charges for the use of automated movie viewing machines (movie peep shows) are not subject to sales tax, but nonetheless contends that the live peep shows and private peep shows are "places of amusement" and hence are subject to sales tax. The Division's position is that the booths which the patrons entered to view the live shows in themselves constituted "places of amusement". Petitioner, on the other hand, equates the peep shows to jukeboxes, video games and other such coin-operated amusement devices. This provides a concrete resolution to this issue since such "devices for amusement" are clearly outside the scope of the Tax Law (*see, Matter of Bathrick Enterprises v. Murphy,* 23 NY2d 664, 295 NYS2d 489). Petitioner points to the New York City Administrative Code § 11-1501.2 which explicitly includes "apparatus booth" within the definition of a "[c]oin operated amusement device" for purposes of applying a tax on such devices, and to the opinions of several Division employees in the MJM case, as persuasive authority for categorizing the peep shows as amusement devices. Neither of these were considered determinative of the issue before us. It is apparent that live peep shows differ from mechanical devices for amusement in that they involve the viewing of a live performer. In fact, the essense of this commercial transaction was the collection of a charge to watch a live sex

show. To treat the charge collected by 1605 as one imposed for the use of a "device for amusement" ignores or distorts the reality of the transaction. Moreover, such a treatment comes perilously close to denominating the performer herself as a "device for amusement". For these reasons, *Bathrick* is deemed not to control here. The question then remains whether the booths themselves are "places of amusement" as that term is used in the taxing statute.

The facts are not in dispute. The patron entered a booth, shut a door behind him, and placed coins or tokens in a slot; a screen or curtain then rose revealing a person who performed for an audience.[6] The booth, coin box, screen and mechanical device for raising the screen were all part of one apparatus. The charge was imposed for the privilege of watching a live performance. It was collected after the patron entered the booth. The amount of the charge was related to the length of the viewing time. Admission to that area of the premises where the booths were located was free.

The mechanical elements of the booth apparatus, i.e., the coin receptacles and rising screens, were the means of collecting the charge and controlling the viewing time, but the reason for entering the booth was to watch the performance. There is no doubt that the sales tax would apply if patrons entered an auditorium to view the same performance in the company of other audience members.

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[6] For the purposes of Tax Law § 1105(f)(1), the differences between the live peep shows and private peep shows are insignificant.

The booths are distinguishable from an auditorium primarily in affording the patron an element of privacy. What is certain at this point in the discussion is that the patron entered a place (the booth) where entertainment was provided. The critical factor then is the nature of the charge collected. Was it an amount paid for admission to a place where entertainment was provided? Clearly, it was. That the charge was collected after the patron entered the booth by means of a coin-operated device is not of determinative legal significance. Keeping in mind that where there is an exclusion under the Tax Law the statute must be construed strictly in favor of the taxpayer (*Matter of Grace v. State Tax Commn., supra*), and that the statute must be interpreted as an ordinary person would read it (*Matter of Fairland Amusement v. State Tax Commn.*, 487 NYS2d *supra*), it is found that the individual booths were "places of amusement" as that term is used in the Tax Law.

F. The next issue is whether admission charges to the theater located on the second floor of 1605 were subject to sales tax. Tax Law § 1105(f)(1) imposes a tax on admission charges to "any place of amusement" except "motion picture theaters". "[A] motion picture theater means any place in which people congregate for the showing of a film" (20 NYCRR 527.10[c][3]). Dr. Winick's testimony was sufficient to establish that 1605's theater was such a place, and the Division conceded as much by stipulation. The Division now contends that 1605's theater is not excluded from the operation of the Tax Law on the ground that the showing of motion pictures in 1605's theater was merely incidental to the live performances

which also took place there. This assertion is not supported by facts in the record. Moreover, the regulatory definition of a motion picture theater contains no words of limitation which would support the Division's argument.

G. The Division has conceded that petitioner's receipts from the operation of the movie peep shows were not subject to sales tax. In addition, it has been found here that petitioner's receipts from charges for admission to the theater were excluded from the sales tax. Petitioner's records did not segregate these charges from those found to be subject to tax, notably the live peep shows. Since the audit proceeded on the theory that all of these charges were subject to tax, no attempt was made by the auditor to determine the source of the various receipts categorized by petitioner as "vending machine and other income". Accordingly, the burden was on petitioner not only to show that certain receipts were not subject to tax, but also to establish the amount of those receipts.

Evidence offered by the petitioner to establish the amount of its receipts in each of the areas under consideration consisted almost entirely of Mr. Wexler's sworn testimony. That testimony was based on Mr. Wexler's review of petitioner's books and records, Mr. Wexler's general familiarity with petitioner's accounting methods and procedures, and his conversations with persons employed by petitioner during the audit period. There was not evidence in the record contradicting his testimony, portions of which were supported generally by other evidence in the record. The Division argues that in order to carry its burden of proof it was necessary that

petitioner present source documents or other forms of documentation to corroborate Mr. Wexler's testimony. There is no authority for this proposition. "Relevant and probative hearsay evidence is admissable in administrative proceedings; moreover, it may . . . constitute substantial evidence to support the administrative agency's determination" (*Matter of Flanagan v. New York State Tax Commn.*, ___ AD2d ___, 546 NYS2d 205, 206).

Through the uncontroverted testimony of Mr. Wexler, petitioner established that its receipts from the live peep shows amounted to $87,353.00 and its receipts from the private peep shows amounted $24,568.00. All other receipts in the category denominated by the petitioner as "vending machines and other income" were not taxable. The Division will reduce the tax assessment in accordance with this finding.

H. In accordance with the stipulation executed by the parties, tax assessed for the periods June 1, 1976 through May 31, 1976 and March 1, 1979 through August 31, 1979 is canceled.

I. Petitioner has not established that this audit was conducted for the purpose of harassing petitioner or in any way interfering with its right to conduct its business; therefore its argument regarding selective enforcement of the Tax Law will not be addressed. Petitioner attacked both Tax Law § 1105(f)(1) and 20 NYCRR 528.6(c)(1) on constitutional grounds. Legislative enactments are presumed to be constitutional at the administrative level, and, in light of Conclusion of Law "D", the constitutionality of the regulations defining periodicals need not be considered here.

J. The petition of 1605 Book Center, Inc. is granted to the extent indicated in Conclusions of Law "D", "F", "G" and "H". The Notice of Determination and Demand for Payment of Sales and Use Taxes Due for the period March 1, 1976 through August 31, 1979 shall be modified accordingly.

DATED: Troy, New York

MAY 17 1990

/s/
ADMINISTRATIVE LAW
JUDGE